BRITISH WAR FINANCE

1914–1919

BY

HENRY F. GRADY

At one time
American Trade Commissioner to London

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To

MY WIFE

INTRODUCTION

THIS book was written in 1919 while the author was in London as American Trade Commissioner, and certain figures not available then have since been added. Likewise, the final chapter has been revised, bringing down to date the principal subjects discussed in the book. It is an attempt to survey the financial developments in Great Britain during the war and for the year succeeding the Armistice. September 30th, 1919, was taken as the date up to which figures were brought, except in cases where it was more convenient to use the full calendar year 1919. Insofar as it was possible, original sources were used and Government documents referred to. *The Economist* was used as a reference on Bank of England and Treasury items. Every effort has been made to secure accuracy, and the author hopes that impartiality has dictated his judgment regarding fiscal policy and currency issue.

So many have rendered assistance in the matter of interviews and the furnishing of actual data, that I could not express my appreciation without writing a very long list of names. Among those who gave unusual assistance, not only in the matter of council and advice but in the actual assembling of data and the preparation of certain tables and graphs, must be mentioned Professor T. E. Gregory of the University of London. Mr. Hartley Withers, then Editor of *The Economist,* and Dr. Walter Leaf, Chairman of the Westminster Bank, also give invaluable aid. Professor James W. Angell of Columbia University has made many valuable suggestions for the final revision of the manuscript. The author, however, does not wish to hold any of these gentle-

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CHAPTER I

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INTRODUCTORY REMARKS

A study of British Finance involves an analysis of many phases of British economic experience during the war period. There will first be examined those preparatory measures which form the prelude to, and the concomitant of public finance in the narrower sense of the term. In subsequent chapters other phases will be studied and discussed. The current phrase which is employed to denote these preparatory and precautionary measures is "financial mobilisation", and this gives a convenient method of approach to the problems surveyed. From the outbreak of the war onwards, financial leaders realised that it would be won as much by "silver bullets" as by anything else. The problem for the government was so to control the various parts of the financial machine as to enable the maximum application of resources to national ends. For this reason it had first of all to devise emergency measures to overcome the financial crisis at the outbreak of the war. It had next to conserve the stock of gold (as far as possible); it was compelled to control the disposition of property in the form of securities in order to regulate the exchanges; it found necessary the prevention of competition between its own capital needs and those of industrial and commercial enterprises not of direct national importance but appealing only to the investor's self-interest.

It may be well to remark here that financial policy is an

organic whole. Certain matters, therefore, which might possibly be treated in this chapter, are postponed for later discussion. This applies particularly to the part played by the Bank of England. It has seemed best to devote an entire chapter to the Bank of England, in spite of the fact that this will necessitate a certain amount of repetition.

We shall now pass to a brief survey of the financial measures taken to meet the emergency which arose on the outbreak of the war.

I. EMERGENCY MEASURES

(a) Emergency Legislation

It was not to be expected that England would escape that breakdown of credit which inevitably followed the beginning of the war; instead, the very fact of her financial supremacy made it certain that any interruption in the flow of credit would be felt most keenly in London.

Thursday, July 23rd, Austria sent its ultimatum to Serbia, throwing the Continental bourses into a state of panic which resulted in their closing early in the following week. On Thursday, July 30th, the Bank of England's discount rate, commonly called simply "the Bank rate", was raised from 3% to 4%, and on the day following it jumped to 8% and on the same day the London Stock Exchange, faced by a rapid fall in all securities, was forced for the first time in its history to close its doors. London's closing decided the New York Exchange to remain closed the next day.

On the same day, Friday, some of the London banks began refusing gold to their customers, paying them in Bank of England notes, for which they might of course obtain gold at the Bank. Accordingly, on Saturday, August 1st, the Bank raised its rate to 10%, and apprehending withdrawals of deposits which would exhaust the reserve in the banking department, followed the time-honored practise of appealing

to the government to suspend the Bank Act of 1844, limiting its issue of notes except in exchange for gold. This permission was at once given and tended to restore confidence, but need never have been made use of, as the government relieved the strain itself by issuing paper currency. In point of fact, however, the permission was used to the extent of a small excess of notes, but this was only because sufficient supplies of the new treasury currency were not on hand. The excess had disappeared before the next weekly statement, since when the limit has not been exceeded. Then the August bank holidays were decreed and these gave the government time to look around and act.

By a royal proclamation [1] dated Sunday, August 2nd, a moratorium on bills of exchange was declared, and by a second proclamation [2] on August 6th, the postponement was extended one month from maturity, or until September 4th, whichever should be the later date, while its provisions were extended to include all obligations except for wages or salaries, debts of £5 or less, taxes, maritime freights, debts of non-residents incurred outside the British Isles, certain trustee funds, bank notes, government debts, and savings bank deposits. The duration of the moratorium was later extended two months more, although the banks ceased to take advantage of it early in September.

The Currency and Bank Notes Act,[3] authorising the Treasury to issue £1 and 10*s*. notes, was passed August 6th, 1914. It was a new departure for the British Government to issue paper money, and in view of the fact that permission had been given the Bank of England six days before to exceed the limit of its fiduciary issue, it has been seriously questioned that this step was necessary. Instead, it has been

[1] Postponement of Payments Act 1914 (4 and 5 G. V., ch. xi).

[2] *Ibid.*

[3] 4 and 5 G. V., ch. xiv.

held that the notes and the manner in which they were issued were largely responsible for the excessive inflation of bank credit and the needless using of bank credit through Ways and Means Advances, which has been so costly to the government.

Had the Bank and not the Treasury issued the emergency currency notes, or had the authority given in the Currency and Bank Notes Act[1] been used to increase the Bank's fiduciary issue to the extent necessary to sustain the credit inflation which war mobilization made imperative, the effect would, on the whole, have been the same. Increased circulating media of small denomination quickly became necessary, however, and the Bank's five pound and larger denomination notes would not have served that purpose. The necessity for one pound and ten shilling notes grew out of the withdrawal of gold from circulation, suddenly increased business activity, and price advances. Had the authorities decided to use the Bank instead of the Treasury as the issuing agency, provision for notes of small denomination would have had to be made.

The currency notes will be discussed later, but a word on the policy of Treasury rather than Bank issue will be appropriate here. Had the Bank made the issue instead of the Treasury, the Bank's gold ratio would have been quickly reduced, despite the steps subsequently taken to draw into the Bank's vaults the total gold supply of the country. The lowering of the ratio to the extent which would have occurred might have adversely affected the public's confidence in the country's solvency. No one is so accustomed as the Britisher to watching the reserve ratio as an index of national financial well-being. Moreover, the effect on the financial clientèle of London the world over was not lost sight of—hence a currency note issued with the authority and backing

[1] 4 and 5 G. V., ch. xiv.

of the British Treasury, through the apparatus of the "currency note account", which served to disguise the bald fact of fiat money and currency dilution on a large scale. The Treasury issue being something new, and having the government behind it, the public did not know or gave little thought to its gold convertibility (which was only theoretical, of course, because of the gold export prohibition). This, however, might not have been the case with bank notes. With a falling reserve, gold might have been extensively demanded and gone to a premium in terms of currency despite the laws to the contrary, as in the case of the greenbacks. A comparison of the greenbacks and the currency notes will be made in a later chapter.

There is, however, another phase of the matter worthy of consideration. If the emergency currency had been issued by the Bank, the Bank might have checked inflation after the first year of the war, during which it is generally conceded to have been necessary. The falling ratio would have served as a warning (even though the normal check through higher rates was impossible), and as the country reached a full war basis, would have emphasized the need of price controls, and of wage fixing, so thoroughgoing as to make unnecessary the large volume of credit creation that went on unchecked throughout the war. It was the mechanism of the "currency note account," and of the Ways and Means Advances, which made price increases practically automatic and inflation cumulative.

To return to a discussion of the currency notes, these notes were to be legal tender throughout the United Kingdom, and were to be payable in gold at their face value at the Bank of England. This was no guarantee, however, of their maintaining a parity with gold, as gold exports were not possible. Postal orders were also temporarily made legal tender, and the notes of all Scotch and Irish banks of

issue were made legal tender throughout their respecti countries, and did not have to be redeemed except at the head offices. Permission was also given the Scotch an Irish banks to exceed their previous fiduciary limits, subje to Treasury approval.

In the terms of the Treasury memorandum on the subjec "Currency notes are issued through the Bank of Englan to bankers as and when required up to a maximum limit n exceeding, in the case of any bank, 20 per cent of its liabil ties on deposit and current accounts." The banks were r quired to give no *quid pro quo* for these advances. The were available merely for the asking. In the beginning th banks paid interest on such currency advances from day t day at the current Bank rate and the notes were a floatin charge in priority of all other charges on the assets of th banks. This was subsequently changed and interest w discontinued, the banks having quickly repaid their advanc though the total outstanding rapidly increased.

Under the provision that a bank might take up to 20 of its deposit liabilities in treasury notes, some 225 millio might have been taken by them at once, but they actually too less than 13 millions. According to Mr. Lloyd George, th mere knowledge that these currency facilities were availab sufficed to restore confidence. Nevertheless, after that tim the issue steadily increased, and on September 30, 1919, stoo at £335,021,000. The issue is secured by a gold reserve o £28,500,000 which has remained constant since June, 191 and by government securities which fluctuate in amount wit the quantity of notes outstanding. On September 30, 191 the amount was £317,536,000. The nature of the securiti has not been disclosed. They are probably mere book entri at the Bank.[1] In August 1919 a new arrangement w entered into whereby £250,000 of Bank of England not

[1] See pp. 25 and 35.

were put into the reserve and held against currency notes. Thus currency expansion was made to affect the position of the Bank of England's reserve—a desirable happening and one of the recommendations in the First Interim Report of the Committee on Currency and Foreign Exchanges After the War.[1]

(b) Relief Measures

The creation of this new currency relieved tension, but it was also necessary to provide some measure of relief for those having heavy liabilities on acceptances and for the Stock Exchange.

The proclamation of August 2nd had provided that all bills accepted before August 4th (August 2nd and 3rd being holidays) should be automatically reaccepted for one month. But although this had prevented wholesale failures, it had done little or nothing toward remedying the situation, and so it was arranged that the government would guarantee the Bank of England against loss in discounting the bills held by other banks and by brokers. It was accordingly announced on August 13:

> The Bank of England are prepared on the application of the holder of any approved bill of exchange accepted before the 4th day of August, 1914, to discount at any time before its due date at Bank rate without recourse to such holder, and upon its maturity the Bank of England will in order to assist the resumption of normal business operations give the acceptor the opportunity until further notice of postponing payment, interest being payable in the meantime at 2 per cent over Bank rate varying.

The phrase "without recourse to such holder" relieved the banks of all further liability on bills which they rediscounted with the Bank of England and very large amounts were so rediscounted, but still conditions improved more slowly than was hoped for. To quote Hartley Withers, former Editor of the *Economist*:

It was a case of a vicious circle. As long as the exchanges did not work, acceptors were not anxious to be drawn on, because they feared that their foreign customers would not be able to remit when the bills fell due. Unless acceptors were ready to be drawn on the exchanges could not work, because there were no bills to be had, and there could not be a free market in exchange.[1]

Finally, on September 5th, it was announced by the government that an arrangement had been made whereby the Bank of England would, where required, provide acceptors with the funds necessary to pay all approved premoratorium bills at maturity, thus relieving all endorsers as the preceding scheme had relieved the holders. The advances were to bear interest at 2% above Bank rate and the Bank was not to press for repayment until one year after the close of the war.

Furthermore, in order to facilitate new business, it was announced that the joint-stock banks had arranged—with the assistance, if necessary, of the Bank of England and the government—to advance to acceptors who were clients of theirs on bills drawn *since* the moratorium went into effect, the amounts necessary to pay their acceptances at maturity if the clients of the acceptors (the drawees) had not provided them with the funds in due time. The acceptor had to satisfy the joint-stock bank or the Bank of England both as to the nature of the transaction and as to the reason why the money from his client was not forthcoming.

Even with this assistance from the government business recovered only slowly. The financial interests, recognising that the severity of the crisis was due largely to the amount of *finance* bills in existence when the war broke out, went to the other extreme and made violent resolutions to restrict finance bills sharply at the very time when they were necessary to revive the flow of credit. Though it continued in

[1] "War and Lombard Street," p. 67.

special cases after that date, the moratorium expired without disturbance on November 4th, 1914.

(c) The Stock Exchange

It was stated by the Chancellor of the Exchequer, Mr. Lloyd George, that the amount of stock-exchange borrowings at the end of July was only between 80 and 90 million pounds, a comparatively small figure. But, outside of the actual dealers, the banks had loaned on stock-exchange securities an amount placed as high as 250 millions, so that the situation was not so favorable as the first statement would indicate.

The Stock Exchange closed on Friday, July 31st, 1914, and remained closed until January 4th following, when it was allowed to resume business only under severe restrictions. The mid-August settlement was postponed under the moratorium until November 18th, when it was effected without serious disturbances. On October 31st, it was announced that the government had arranged with the Bank of England "to advance to lenders to whom the scheme is applicable 60% of the value of the securities at present held by the lenders against any loan which they had outstanding on July 29th, 1914, such securities to be valued for the purpose of the advance at the making-up prices for the July 29th settlement."

The matter of determining "to whom the scheme was applicable" was left to the Bank of England. It could refuse any application, but was to bear in mind the government's desire to prevent the forced sale of securities. Both lender and borrower were made jointly liable for repayment, and the time of application was limited to January 31st, 1915. Loans under the arrangement bore 1% interest above Bank rate, with a minimum rate of 5%. Interest was to be paid fortnightly and after the reopening of the Stock Exchange at the regular settlement dates. The Bank of Eng-

land agreed not to press for repayment until one year after the close of the war. The provisions of the relief were to be extended to provincial stock exchanges and to the Liverpool Cotton Exchange.

An appeal of the Chancellor of the Exchequer for a list of stock-exchange borrowings showed that there were some 80 millions in London and 11 millions in the rest of the country and that of their total about 77 millions was adequately covered. As the *Economist* of November 21st observed, however, this did not represent the full amount, as millions of pounds of stocks and shares then standing in the names of exchange men and their clients had been taken over and held by them rather than thrown upon the market for sale.

The regulations under which the stock exchange resumed business January 4th, 1915, were that it might remain open only from 11 to 3 o'clock, and to 1 o'clock on Saturdays, that all sales must be for cash, settled not later than the day following the sale, and that no sales were to take place below fixed prices. Options and arbitrage transactions were forbidden, and the exchange was not permitted to deal in issues made thereafter unless specifically approved by the Treasury. In order to prevent the sale of enemy securities a certification that the securities in question had not been in enemy ownership since the outbreak of the war, and had actually been in the United Kingdom since September 30th, 1914, was required for a good delivery.

II. THE CURRENCY POLICY OF THE GOVERNMENT

(a) Paper Currency Policy

The paper currency policy of the government had two chief aspects: (a) regulations affecting the note issue of the Bank of England and the Scottish and Irish Banks; (b) provisions for a new emergency treasury note issue. Both these lines of policy had the same fundamental legislative authority; namely, the Currency and Bank Notes Act of

1914;[1] and they also had the same object of increasing the supply of legal tender currency available.

So far as the first point is concerned a short descriptive note will suffice, since the matter must be again treated in the chapter dealing with the activities of the Bank of England. Under the law as it stood in August 1914, the Bank of England could increase the volume of its notes outstanding in excess of £18,450,000 only by increasing the amount of gold held in its Issue Department. The Scottish and Irish banks at the same date could increase the note issue in excess of an amount fixed for each of them only by an amount equal to the average amount of gold and silver coin each held during any period of four weeks.

The Currency Act eased the situation by providing in Section 3 that treasury sanctions might be given to "issue notes in excess of any limit fixed by law" and indemnifying the issuing banks for any such excess issues made by them since August 1st, 1914. Further, by Sec. 4 it was ruled:

> Any bank notes issued by a bank of issue in Scotland or Ireland shall be legal tender for a payment of any amount in Scotland or Ireland respectively, and any such bank of issue shall not be under any obligation to pay its notes on demand except at the head office of the bank, *and may pay its notes, if thought fit, in currency notes issued under this Act:*[2]
>
> Provided that notes which are legal tender under this section shall not be legal tender for any payment by the head office of the bank by whom they are issued for the purpose of the payment of notes issued by that bank.
>
> This section shall have effect only until His Majesty by proclamation revokes the same, and any proclamation revoking this section may provide for the calling in or exchange of notes affected thereby.[3]

[1] 4 and 5 G. V., ch. xiv.

[2] Italics not in original.

[3] Revoked by proclamation as of January 1st, 1920.

In substance the Bank of England and banks of issue in Scotland and Ireland might on Treasury sanction increase their issues without the legal limitations, *and* the latter might use currency notes as backing, for which no sanction was required. In this way the note policy of the latter banks of issue became linked up with the terms upon which notes might be obtained from the Treasury.[1]

Let us now return to the emergency currency note itself and the provisions for its issue.

No one reading the terms of the original act and the minutes and statements of the treasury in the days of August 1914, can fail to be struck with the obvious intention that the whole note policy was to be temporary, devised to meet the extraordinary demand for currency and intended to be withdrawn as soon as possible.

Section 2 of the Act laid it down that "Currency Notes may be issued to such persons and in such manner as the Treasury direct, but the amount of any notes issued to any person shall, by virtue of this Act and without registration or further assurance, be a floating charge in priority to all other charges, whether under statute or otherwise, on the assets of that person." The original minutes in fact only contemplate issues to bankers, the maximum issues contemplated, in the case of any one bank being 20% of its liabilities on deposit and current accounts.

An official statement [2] explained that

[1] In a treasury minute of August 6th, 1914 (*Financial Edn. D. O. R. Manual*, p. 7 *et seq.*) sanction was to be given to a total issue equal to 20% of liabilities on current and deposit account on the last monthly balance sheet, subject to the condition that the average monthly circulation be not in excess of the original fiduciary circulation plus the average monthly holding of gold and silver currency and treasury notes. The fact that this was regarded as "an issue of notes in excess of any limit fixed by law" as the minute says, shows how uncertain was currency policy at that time.

[2] Explanatory Memorandum by the Treasury to Currency and Bank Notes Act, 1914.

The amount of notes issued to each bank is treated as an advance by the Treasury to that bank bearing interest from day to day at the current bank rate, the security for the Treasury advance consisting of a floating charge on the assets of the bank up to the amount of the notes issued. The bank is permitted to repay the whole or any part of any advance at any time. Any amount repaid can be renewed if and when necessity arises provided that the total amount outstanding at any time does not exceed the authorised percentage of the bank's liabilities.

Any sums received by the Bank of England in repayment of advances are either applied forthwith to cancelling any Currency Notes which have been returned from circulation and are for the time being in the hands of the Bank of England, or, in so far as any such sums may exceed the amount of Currency Notes returned from circulation in the hands of the Bank of England at the time of receipt, are carried to a separate account in the books of the Bank of England and applied to the cancellation of notes as and when they return from circulation.

In order to give the banks the advantage of the credit allowed under this arrangement even though actual currency may not be required, it is proposed by the amending Bill to take power to issue certificates in lieu of actual notes. The effect of the issue of these certificates will be that the banks will be able to obtain credits with the Bank of England on the same terms as Currency Notes and the expense of printing and handling notes will be avoided, except in so far as the notes may be required for actual circulation.

The last two paragraphs in particular deserve attention: The intention clearly was to put a currency certificate on the basis of a security which could be negotiated with the Bank of England, so as to increase the "reserve" of the institution which has been advanced such security by the government. These arrangements were formally sanctioned by a treasury minute of August 6th, 1914, but as will be seen from the statistics of notes issued, etc., tabulated on page

28, the volume of notes outstanding constantly increased, while the advances to bankers were an almost insignificant fraction of the whole. The contention that the notes were primarily an advance to bankers cannot longer be sustained; and, in effect, a little-noticed clause in a treasury minute of August 20th, 1914 "as to the issue of currency notes" already indicates a change of principle. By that minute,—

> Currency notes as well as being issued in accordance with paragraphs (2) and (3) of the treasury minute of the 6th instant *shall be issued to any person upon application*, through the Bank of England, *on payment of the face value of the notes required*, the amount paid being carried to the separate account . . . to be called the Currency Notes Redemption Account.[1]

This meant that the notes were not merely an *advance* to banks with the bank's assets as security, but could be secured on *payment of their face value*, that is, by check against an account at the Bank of England. Hence the banks, in order to save interest charges, quickly repaid "advances" and drew currency notes or certificates by debits to their account as required. Individuals could secure currency as needed either directly, if they had accounts at the Bank, or indirectly, through the joint-stock banks. These joint-stock bank credits at the Bank of England were built up largely by the Treasury's payment of Ways and Means Advances to the Government's creditors, who in turn deposited them with the banks. Moreover, the banks' deposits were pyramided by the Bank of England's borrowings from the banks, which were again transferred to government creditors for deposit with the banks.[2] In a word, legal tender currency was constantly on tap to supply the demand for circulating media or to furnish "reserve" for bank inflation.

[1] Italics not in original.

[2] For a full discussion of this process, see p. 147.

It is clear that this indicated a change of attitude and the conception of the currency note as an emergency issue had long since been forgotten in practical discussions on the subject.

It is now necessary to turn to the technical features, i. e., the arrangements made for convertibility and redemption. By Sec. (3) of the Act "the holder of a currency note shall be entitled to obtain on demand during office hours at the Bank of England, payment for the note at its face value in gold coin, which is for the time being legal tender in the United Kingdom". As the government had as much as possible discouraged the use of gold, this legal right of conversion into gold on demand was probably not of any practical importance, but it raises interesting questions of principle. The note issue was managed—so far as issues were concerned—by the Bank of England for the Treasury and undoubtedly a special account was kept at the Bank as part of the Note Redemption Fund.

The exact fiscal relations of the Treasury and the Bank in regard to treasury notes have never been revealed. This is equally true of the advances of surplus balances by the joint-stock banks to the Bank. No light on this matter can be secured from the Weekly Returns of the Bank of England, nor is there any correspondence between such advances and Government Securities or Public Deposits. Moreover, the exact relation of the Treasury to the Currency Note Account does not appear anywhere except in the mere item of Government Securities, (undoubtedly mere book entries) although the Treasury undoubtedly drew against the full credit established by the notes outstanding. Some special unpublished account must have been kept by the Treasury with the Bank. In fact, opinion in financial London had it that the special arrangements were that the Bank, at the end of each day's business, accounted with the

Treasury, i. e., only issued notes as the agent of the Treasury and held none on its own account at all. Supposing, however, notes to have been exchanged for gold, what would be the effect? The direct effect would be to diminish the Bank's gold reserve and correspondingly to reduce the Bank account of the Note Redemption Fund and the total of notes outstanding. But, this would mean that the note was practically converted into gold at the expense of the Bank. Since the Treasury holds a gold reserve, some hitherto unpublished arrangements must have been made as to the position, should the conversion of the note into gold have assumed serious proportions. The position was somewhat altered in July 1919, by placing in the Note Redemption Account, Bank of England notes which gave the Treasury a further grip on the Bank's gold. This is a point which will again come up for discussion later.

The following table will show the organisation of the note issue better than any verbal explanation. The figures given are those for the return dated September 24th, 1919:

LIABILITIES

Notes and certificates outstanding	£331,174,000
Investment reserve account	15,888,000
	£347,062,000

Against these liabilities, the note account held the following:

ASSETS

Advances to bankers	£250,000	
" to savings banks	320,000	
		£570,000
"*Redemption Account*," viz.		
Gold coin and bullion	£28,500,000	
Government securities	314,036,000	
Balance at Bank of England	3,106,000	
Bank of England notes	850,000	
		346,492,000
		£347,062,000

Another item which requires a word of explanation is the "Investment Reserve Account", which came into existence as the result of a treasury minute dated May 3rd, 1915 [1] as to interest on currency note advances and on securities held on account of the Currency Note Redemption Account." The salient point in this minute is that

The Chancellor now proposes that all interest received whether upon advances made in currency notes or upon securities held for the Currency Note Redemption Account should be utilised, in the first place, in order to provide a fund for meeting any losses which may from time to time be incurred upon the realisation of the securities, and that the balance after making suitable provision for this purpose should be paid into the exchequer, and he accordingly recommends that their Lordships should give directions that (1) The interest on all advances made in currency notes and on the securities held for the Currency Note Redemption Accounts shall as it accrues, be credited to the assets of that account as shown in the weekly return, and the amount so credited shall be shown under a separate heading among the liabilities under the title of "Investments Reserve Account." (2) The securities held on account of the Currency Note Redemption Account shall continue to be shown on the return at cost price and any profit or loss upon realisation, or repayment, shall when it accrues be credited or debited as the case may be to the "Investment Reserve Account". Any advances made in currency notes which may prove to be irrecoverable shall when written off be debited to that account. (3) If at any time the amount standing to the credit of the Investments Reserve Account exceeds by more than £100,000 the proportion which may be fixed by their Lordships from time to time as necessary to provide an adequate reserve, due regard being had to the character of the securities held and of the other assets of the fund, the whole amount of the excess over the fixed proportion shall be transferred to the Exchequer.

[1] *Financial Edition*, pp. 15-16.

My Lords concur and are pleased to direct that the amount below which the balance of the Investments Reserve Account shall not be reduced by transfers to the Exchequer be fixed for the time being at 5% of the total securities held and advances outstanding.

The Investments Reserve Account first appeared in the return on January 5th, 1916, with an entry of £740,684.

The following table gives the yearly status up to 1919 of the currency note, so that it is not necessary to spend time over details at this point:—

CURRENCY NOTES OUTSTANDING AND REDEMPTION ACCOUNT

(Figures in millions)

Date	Notes and Certificates outstanding	Advances to Bankers	Redemption Account			
			Gold Coin and Bullion	Ratio of Gold and B. of E. Notes to Currency Notes	Government Securities	Balances at Bank of England
	£	£	£	%	£	£
1915 Aug. 4 ...	46.7	1.8	28.5	61.0	9.6	7.4
1916 Aug. 2 ...	127.7	.2	28.5	22.4	92.7	8.6
1917 Aug. 1 ...	168.5	.4	28.5	16.9	141.6	5.2
1918 July 31 ...	263.3	.7	28.5	10.8	240.4	5.7
1919 July 30 ...	338.8	.5	28.5	8.4	323.3	3.3

It will be noted that the ratio of gold to notes was at its maximum in 1915 and fell steadily from then on. A study of the weekly return[1] down to September, 1919 will show the maximum issue was that of April 30th, 1919, i. e. £348,-339,000. The advances to bankers reached their maximum

[1] See Bankers Almanac 1920, or later years.

in the first two weeks of the return, fell rapidly in 1915 and 1916 and have been relatively small ever since. There is no evidence to show that advances were being used for "window dressing". The rise in the advances to savings banks in November and December 1917 was due in all probability to withdrawals for Christmas purchases.

The rapid increase in the volume of notes outstanding, the fall in the gold ratio and the continuance of the rise in prices [1] had, even before the Armistice, caused some criticism of the policy of the government. Foremost in the attack was Professor J. S. Nicholson of the University of Edinburgh, a distinguished economist and writer upon monetary matters. With the publication of the report of the Committee on Currency and Foreign Exchanges, the Armistice and the freeing of the public mind from immediate preoccupation with the issue of the conflict, passage was made into an atmosphere decidedly critical of the policy of unrestricted note issue. Three phases may be distinguished: (1) The proposals and criticisms of the City; (2) The attitude of the Committee on Currency; (3) The efforts at reform. These three points will now be considered.

1. *The opinion of City authorities:* At the company meetings of their respective banks in January 1919, two great practical authorities—the late Sir Edward Holden, of the Midland Bank, and Mr. F. C. Goodenough of Barclays Bank developed their views fully.[2]

Sir Edward Holden in addition to some strictures upon the present constitution of the Bank of England, which will require attention in the chapter on the Bank of England, developed at some length a criticism of the currency note

[1] The rapid rise in British prices during the war is shown in the graph on p. 166. Prices increased two and a half times between the outbreak of the war and the Armistice.

[2] Their speeches will be found in full in the *Economist* for February 1, 1919.

as based upon a wrong principle of issue—in his view the nature of the securities held, i. e. treasury bills, are unsafe. Speaking of the Reichsbank which had been given the power during the war to issue notes against treasury bills, he said: "It may be noted here that an issue of notes against treasury bills is wrong in principle because it is not certain that the bills will be paid off when they mature. We propose to refer to this question later. . . ." The later statement was to the effect that

A large and increasing volume of trade entails an increased use of bills of exchange and requires an expansion of currency. To provide the expansion of the currency an issue of notes against bills of exchange by the joint-stock banks seems to be the simplest and safest way of meeting trade requirements, but the total issues should be limited to the amount of the gold reserve. When trade diminishes in volume and the total of bills of exchange outstanding is reduced, the total of notes outstanding must also automatically be reduced. It will be observed that in this system the currency in circulation is not increased unless there has been a previous increase in the volume of goods produced, as the bills of exchange which are discounted for currency must be commercial bills representing goods. Hence there is no similar effect upon prices consequent on an increase in currency obtained in this way as would be the case when notes are issued against securities not representing goods such as treasury bills.

Mr. Goodenough said,

the further issue of currency notes should now be stopped so that the amount already issued will have a definite ratio to the gold held in reserve, and this ratio may be gradually improved. If there is still need for further currency, it would be preferable in order that the desirable step of limiting the present issue of notes may be taken, for the banks to be authorized again to issue their own notes within prescribed limits. These notes would have behind them real values in the shape of legal tender and

approved negotiable bills beside other ordinary assets. This method would act as a bridge between the present unsatisfactory system and the time when we can once more establish our currency on a permanent footing, the basis of which has yet to be decided. Naturally the right of issuing notes given to the Bank of England would require to be dealt with in a just manner, as also would the profits arising from any issues made by the banks.

A third point of view, also emanating from the City may be contrasted with the preceding. Mr. Falconer Larkworthy, of the Ionian Bank, speaking at the general meeting of his Bank on June 5th, 1919, said that as against the findings of the Currency Committee he wished to record

a deep conviction that our present currency note system is sound in itself, completely acceptable to the community, perfectly elastic and properly and fully covered, and that neither the government nor the banking world need trouble themselves for a moment with the questions of redemption or convertibility. . . . And further, our currency note system is capable of immediate adaption to the international system which we have advocated so long and which is now being realised so swiftly (i. e. international drafts based on deposit of securities—" liquid wealth ").

It is necessary to consider seriously the possible advantages which would accrue to the British financial system from the adoption of the plan to give joint-stock banks the right to issue notes against bills. There seems in all this discussion to be a misunderstanding as to the place which the currency note ought to play in a banking system such as the British. In that system an adequately elastic medium is *already* provided in the loan against collateral security,—a loan which mainly takes the form of a bank deposit, as Hartley Withers has lucidly explained.[1] Now under these circumstances the ex-

[1] *In the case of a single bank*, the limit to this process is given by the

tension of the deposit loan really *makes necessary a further currency medium for banking purposes.* Gold and Bank of England notes have heretofore served that purpose. What is wanted in the British system is a note permanently replacing gold currency as a medium of exchange. To adopt the proposals of Sir Edward Holden and Mr. F. C. Goodenough would tend to throw British banking back into the era from which it evolved after about 1830—the era in which the loans made by banks took the shape of notes. The other function which the currency note played during the war—a legal tender instrument—could obviously not be granted to the notes issued by joint-stock banks. As against this point, the suitability of bills as a backing for notes is really a minor question, although it may be remarked in passing that bankers are somewhat inclined to overstress the inevitability of an automatic contraction of the currency when the bills against which they are issued mature. To insure this some such careful regulation as that provided by the Federal Reserve System would seem to be necessary. Likewise, there would be required some definite tie-up with the note issue of the Bank of England. Without this the Bank's control of the national gold reserves and of money rates, which has at times been difficult under the present system, would be well nigh impossible. The fact is that the currency note has influenced bank loans *indirectly* for, being legal tender and freely obtainable from the treasury it has enabled the bankers to increase their reserves easily but it has not replaced the deposit loan as the typical "money" of British business.

fact that such credit creation reduces the clearing balance of the bank granting the loans through transfers of checks on it to depositors of other banks. But at a time of general expansion of credit the relative position of all banks may be unchanged. For a fuller explanation see: Hartley Withers, "The Meaning of Money," p. 64 *et seq.*

2. *The Report of the Currency Committee:* The report of this Committee is already classical. The subject is approached from the angle that the restoration of an effective gold standard is the most pressing of the financial problems confronting the country, though the Committee do not desire to see a gold currency. In other words what they desire is to secure convertibility into gold and thus to secure the reestablishment of gold parity with foreign currencies. To effect this, a limitation of the fiduciary issue is a *sine qua non*, and the device of effectively regulating demand for money by variations in the Bank rate an absolute necessity. The ultimate ideal of the Committee is thus a single unified note issue in the hands of the Bank, the volume of fiduciary notes to be regulated ultimately by the size of the gold reserve which it is deemed desirable to conserve, and this latter amount is provisionally fixed at £150,000,000.[1]

We accordingly recommend that the amount to be aimed at in the first instance as the normal minimum amount of the central gold reserve should be £150,000,000 and that until this amount has been reached and maintained concurrently with a satisfactory foreign exchange position for a period of at least a year, the policy of reducing the uncovered note issue as and when opportunity offers, should be consistently followed. In view of the economic conditions which are likely to follow the restoration of peace it will be necessary to apply this policy with extreme caution and without undue rigidity. When the exchanges are working normally on the basis of a minimum reserve of £150,000,000 the position should again be reviewed in the light of the dimensions of the fiduciary issue as it then exists. If these arrangements are adopted, there will be an interim period beginning after the completion of demobilisation during which it is probable that the present issue of currency notes will have to be gradually reduced until experience has

[1] Practically all the recommendations of the Committee have now (1926) been carried out, and ultimately all will be.

shown what amount of fiduciary notes can be kept in circulation consistently with the maintenance of this reserve. It is suggested to us in evidence, that, until that amount has been ascertained, steps should be taken as soon as possible after the war to reduce the uncovered issue at the rate of not less than 3% per annum of the outstanding amount and that subject to arrangements for meeting a temporary emergency, the issue in any period of six months or one year should not be allowed to exceed the amount in the preceding similar period. We think that it would be highly desirable to aim at a steady and continuous reduction, but we are disposed to doubt whether it will be found practicable to work to any precise rule. We confine ourselves therefore to the general recommendation of policy indicated above. We entirely concur, however, in the suggestion that, when reductions have taken place, the actual maximum fiduciary circulation in any year should become the legal maximum for the following year, subject only to the emergency arrangements proposed in paragraph 33 (Treasury sanction of excess issue).

The *immediate* solution which the Committee proposed was that until the note issue is finally taken over by the Bank (which should not occur before the size of the fiduciary circulation is definitely fixed),

the issue should remain a government issue, but that such post-war expansion (if any) as may take place should be covered not by the investment of the proceeds of the new notes in government securities as at present, but by taking Bank of England Notes from the Bank and holding them in the Currency Note Reserve and that, as and when opportunity arises for providing cover for the existing fiduciary portion of the issue the same procedure should be followed. The effect of this arrangement will be that the demands for new currency will operate in the normal way to reduce the reserve in the Banking Department of the Bank of England which would have to be restored by raising money rates and encouraging gold imports.

This proposal really puts its finger on the most vicious

aspects of the currency note issue as it worked during the war. Inflation was made possible without a rising Bank rate, partly by checking gold exports and conversion, but also by the fact that the currency note was *purchasable* at its face value from the Treasury and was at the same time unlimited legal tender. The manner in which this took place has been pointed out above. Any individual or bank who had a credit could convert it into legal tender by the process of checking against that credit. Credits are largely created by loans. The government's credits were secured by loans of some kind or other, and through the process of transferring these credits to its creditors the government made it possible for them to exchange credits for legal tender likewise created by the government itself.

"Cash Reserves" could thus increase *pari passu* with increase of loans without affecting the position of the Bank of England's gold reserve. Thus the banks were freed of dependence on the gold reserve of the Bank for credit expansion. They had at their command the Currency Note Account, which worked easily and almost automatically after it was set in motion. Advances were made to the Treasury on the books of the Bank by a mere bookkeeping entry. "Government securities", which presumably *secured* these advances, probably were not such in any proper sense of the term. They were in all likelihood mere memorandum debits. The use of these credits by the government, as was also the case with the Ways and Means Advances, transferred them to the banks and in turn back to the Bank of England, where they became available for the liquidation of indebtedness to the Currency Note Account or for the drawing of currency notes directly from the Bank. These notes then went into general circulation or became "reserves" for loans to private parties and to the Bank of England, under the special interest paying arrangements. Such loans

to the Bank were in turn again loaned to the government as advances and the whole vicious process was repeated over and over. The currency note had not been intended as an agency for such abuse of sound currency principles, but it became so in effect and made money and credit creation a purely arbitrary power of the Treasury. In the final analysis, the source of currency notes was the printing press, and the basis of Ways and Means Advances a stroke of the bookkeeper's pen. The Bank in effect abrogated its position as the final reserve authority, which passed to the treasury authorities. Had the latter pursued a policy of restriction,—in effect, the policy of regulating money demands by a rise in the Bank rate,—far less harmful results from the currency issue would have followed. As things worked out, the Treasury took the view that it had no right to check "demands" for notes. The more prompt adoption of the Currency Committee's proposals *together with a rigorous screwing up of the rate for money* so as to check further demands, would have once again restored a central reserve, the size of which would have regulated all demands for money.

3. Although the Report was rendered in August, 1918, it was not until August, 1919, that the Treasury started holding Bank of England notes in the redemption account. Between July 30th, 1919 and November 5th, 1919, the movement was as follows:—

(*Figures in millions of pounds*)

	Notes & Certificates	Invest. Reserve Account	Total	Advance to Bankers	Coin	Securities	Bank of England Notes	Balance at Bank of England
July 30..	£338.79	£16.83	£355.62	£.48	£28.50	£323.38	..	£3.31
Nov. 5, 1919..	£339.75	£16.05	£355.80	£.57	£28.50	£321.33	£2.35	£3.04
Changes.	+.96	—.78	+.18	+.09	Nil	—2.00	+2.35	—.27

In the same period the Banking Reserve of the Bank of England fell from £27.48 millions to £20.45 millions, a net decline of £7.03 millions, of which £2.35 went to the Currency Note Account. In the interval between two later returns the position of the Note became worse, since between October 30th and November 30th the note issue increased by £3,172,377, while the Bank of England notes held, only increased by £600,000. While over the whole period from July 30th to November 30th the position improved, it did not to do consistently. The rise in the Bank rate to 6%, announced November 6th, 1919, had probably an intimate connection with the facts analysed here, and indicated a welcome return to the old and tried policy of regulating money demands.

(b) *Metallic Currency Policy*

We have just discussed the history of the currency note. Issued originally as "emergency" currency, it later became current legal tender of the realm, the avowed policy of the government being to discourage the use of gold as much as possible. On August 8th, 1915, the Treasury instructed

> the Post Office and all public departments charged with the duty of making cash payments to use notes instead of gold coins whenever possible. The public generally was earnestly requested in the national interest, to cooperate with the treasury in this policy, by (1) paying in gold to the Post Office and to the banks; (2) asking for payment of checks in notes rather than in gold, and (3) using notes rather than gold for payment of wages and cash distributions generally.[1]

Thenceforward the danger lay in the use of gold coin for

[1] Quoted from "Labor, Finance and the War," being the results of enquiries arranged by the sections of Economic Science and Statistics of the British Association for the Advancement of Science during the years 1915-1916," p. 240.

Tables Illustrating Currency Policy During the War

1. Aggregate growth in legal tender currency during the war period.[1]

(Figures in millions of pounds)

	June 30, 1914 [2]	*June 26, 1918*	*June 25, 1919*	*Oct. 15, 1919*
Fiduciary Issue of the Bank of England ...	18.45	18.45	18.45	18.45
Bank of England Notes issued against gold coin or bullion	38.48	64.61	85.74	86.24
Total Bank Issue ..	56.93	83.06	104.19	104.69
Uncovered Currency Notes	——	224.41	313.81	308.19
Currency Notes covered by gold or Bank of England Notes	——	28.50	28.50	30.25
Total Currency Note Issue	——	252.91	342.31	338.44
Estimated stock of gold coin held by banks, other than gold coin held by Bank of England and in circulation	123.00	40.00 [3]	40.00 [3]	40.00 [3]
Total	179.93	375.97	486.50	483.13

2. Growth in Fiduciary Issue of legal tender currency.

	June 30, 1914	*June 26, 1918*	*June 25, 1919*	*Sept., 1919*
Bank of England Notes	18.45	18.45	18.45	18.45
Currency Notes	——	224.41	313.81	308.19
Totals	18.45	242.86	332.26	326.64
Percentage of fiduciary issue to Total legal tender and currency at those dates	10.2%	64.6%	68.3%	67.6%

[1] Exclusive of Notes of Scottish and Irish Banks.

[2] Taken from First Interim Report of the Committee on Currency and Foreign Exchanges. Cd. 9182, par. 13.

[3] Estimated by Committee on Currency and Foreign Exchanges in First Interim Report. Cd. 9182, par. 13.

purposes other than currency or backing for notes and deposits, i. e. hoarding or melting rather than in anything like an undue extension of gold payments. Hence the following regulations were successively issued:—

On December 5th, 1916, there appeared Regulation 30 E. by which "A person shall not melt down, break up or use otherwise than as currency any gold coin which is for the time being current in the United Kingdom, or in any British possession or foreign country; and if any person acts in contravention of this regulation, he shall be guilty of a summary offence against these regulations."

By paragraph (2) of Regulation 30 EE of May 18, 1918, "Any person who sells or purchases, or offers to sell or purchase, any coin current in the United Kingdom for an amount exceeding the face value of the coin, or accepts or offers to accept any such coin in payment of a debt or otherwise for an amount exceeding its face value shall be guilty of an offence against these regulations."

The object of these latter regulations was, of course, to prevent a premium on gold and differential prices—a policy which was on the whole successful, although cases were brought before the courts where more than the face value of the coin had been offered. A gold premium might have existed, and gold been secretly dealt in despite these regulations, had it been possible to realize on such a premium through smuggling the gold out of the country. This in itself was difficult because of widespread war conditions, and because the exchange on New York, the only real market for gold, was "pegged" at a point so near par. This matter will be discussed at further length in the section on the greenbacks.[1]

So far as *silver* was concerned, the following regulations explain themselves. Paragraph (1) of 30 EE. cited above, runs:

No person shall after the 27th day of May 1918, have or retain at any time in his possession or under his control silver coins current in the United Kingdom of a value exceeding that of an amount of silver coinage reasonably required by him at that time for the purposes of the personal expenditure of himself and his family and of his trade or business (if any); and if any person acts in contravention of this regulation he shall be guilty of an offence against these regulations. In any proceedings for contravention of this regulation the burden of showing what amount of silver coinage is reasonably required for the purposes aforesaid shall rest upon the person charged.

The Government, on August 2, 1918, also took power to regulate prices for silver by the issue of Regulation 30 EEE. The Regulation stated:

(1) It shall be lawful for the Treasury to make orders fixing a maximum price for silver bullion.
(2) Any order made under this regulation may contain such supplemental provisions as appear to the Treasury necessary or expedient for giving effect to the order, and may be revoked, extended or varied, as occasion requires.
(3) If any person sells or purchases, or agrees or offers to sell or purchase, except under a license in writing granted by the Treasury, any silver bullion at a price exceeding the maximum price, or otherwise infringes an order, he is guilty of an offence under the regulation.

(c) Post Armistice Developments

The metallic currency situation in Great Britain was at once affected by the "unpegging" of the American exchange in March, 1919. What had up until then been merely a patriotic piece of self-denial on the part of bankers was now converted into a statutory obligation. The fall in the dollar value of the pound increasing the temptation to export gold, the government took certain meas-

ures to prevent this towards the end of March 1919. In its issue of April 3rd, 1919, the Board of Trade Journal announced: "that an Order in Council prohibiting the exportation of gold coin and bullion was issued on Tuesday, 1st April. Pending the issue of the Order, the Board directed the Commissioners of Customs and Excise to take action to prevent such exportation as from 28th March in accordance with their powers under Section 3 of the Customs (War Powers) Act, 1916. . . ."[1]

(d) Gold Production and Gold Stocks

Two questions remain to be discussed; the first[2] of these follows directly from the above and concerns the position of the South African gold mining companies. The second concerns the stocks of gold in the country.

(1) *Report of Gold Producers' Committee:* In July 1918 there was sent by the "Gold Producers' Committee" to the Chancellor of the Exchequer a statement setting forth the importance of gold production to Imperial trade and finance, pointing to the drop in gold production due to rising costs, and stating that there was a danger "that mines in South Africa alone now producing over £7,000,000 per annum, are likely to be closed down. We may observe that the cost of reopening such mines would be so great that there is grave probability of their never being reopened." They placed the case for consideration not only on the grounds of higher mining costs, but also on the fact that

> the price of other commodities . . . has risen at least in the ratio of their increased cost of production. It is also a matter of common knowledge that, in cases where the Government has found it necessary to control the price at which certain commodi-

[1] *Board of Trade Journal*, April 3, 1919.

[2] On the whole of what follows see the report of the Committee on Gold Production. Cd. 11, 1919.

ties may be marketed, it has endeavored to fix the price at a figure which will allow the producers a profit. In the case of gold, however, though the cost of mining it has risen, the consideration paid in exchange for it is worth less than in prewar days.

The correctness of this view is manifested generally by the falling output and lower profits earned by surviving gold mines, by the value of gold as expressed in the currency of allied and neutral markets, and to a minor extent, by its value in the manufacturing trades.

A South African Committee had already studied the subject early in 1918 and had been confronted by two separate proposals for a subsidy. The demand for a subsidy was not agreed to by the Committee, which recommended that " steps should be taken to control (a) the amount of development work that may be carried on by each mine; (b) the allocation of stores and especially explosives; (c) the allocation of the available labor force."

On December 27th, 1918, the British Treasury appointed a committee " To consider and report upon the gold production of the British Empire with reference more particularly to the treatment of low grade ores and how it may be of importance to the national interest to secure the continuance of the treatment of such ores and generally how to stimulate the production of gold."

Before dealing with the vital point of the committee's report,[1] it may be well to say a word on the conclusions as a whole. The committee found that:

(1) . . . taking the period of the war as a whole the production of gold in the Empire exceeded the production during the corresponding period immediately preceding it.

[1] Report of the Committee on Gold Production. Cd. 11, 1919.

(2) In 1917 and 1918 there was a decline in production as compared with the immediately preceding year of £3.4 million and £4.6 million respectively. They go on to state "that the decline in the Transvaal in 1917 was due to a combination of shortage of explosives and shortage of labor, of which the shortage of explosives due to the war was of more importance, and in 1918 mainly to the shortage of labor not due to any large extent to the war.

That the decline in Australasia in 1917 and 1918 was normal and due in the main to natural causes, but that it was accelerated by the increase of costs and decrease in efficiency of labor caused by the war.

(3) That up to the date of our appointment the treatment of low grade ore in the Transvaal has not to any extent which can be determined, been reduced by the war.

(4) That from the point of view solely of gold production the abandonment of the treatment of low grade ore in favor of higher grade ore will not within any measurable period reduce the total output of the Empire and that the continuance of low grade mines which are unable to work at a profit to themselves is not therefore a matter of any great importance to national interest.

(5) We are not prepared to recommend any bounty or subsidy for the purpose of stimulating the gold output of the Empire: *gold being the standard of value no more can properly be paid for it than its value in currency*." [1]

The italicised portion of this last statement brings one to the center of the argument. Elsewhere the Committee say

a subsidy for the production of gold appears to us to be fundamentally unsound. Gold has been adopted as the standard of value because, by reason of the operation of natural forces, it is available in such quantities and at such a cost of production in terms of other commodities as to give it a more or less stable

[1] Italics not in original.

value. Its value, in terms of commodities, is directly influenced by the laws of supply and demand. Periods of increased gold production, following on the discovery of further deposits of gold capable of extraction at a low cost have been marked by an increase in the price of commodities. The exhaustion of these sources of supply has been accompanied by a decline in the price of commodities.

The intention of the suggested subsidy to the gold producers is to enable gold to be produced which otherwise would not, conformably with the economic laws of supply and demand, be produced at all. Other things being equal, the result would be that the purchasing power of the whole of the world's gold would be diminished *pro tanto*. The value, in terms of gold, of the commodities for which it is exchanged, would rise.

It is undoubtedly desirable that considerable gold reserves should be held in this country but in our view the most important function of a gold reserve is that gold from the reserve should be available for export at the standard price when required to meet foreign indebtedness. We think it essential to preserve a free market in gold, but clearly it would not be a business proposition to do so if we had to pay £4. 10. 3d. for an ounce of gold in order to export it at £3. 17. 10½d.

We can only maintain our gold reserves in this country if the value of our exports, visible and invisible, exceed on the balance the value of our imports. If we want gold and cannot produce it at a profit, we must depend on our capacity to render services and to produce at a profit the commodities wanted elsewhere by the holders of gold and to do so we must adjust our prices to world prices.

We shall not be able to keep gold which we acquire by means of a subsidy if the balance of trade is against us, and apart from the shareholders in gold mining concerns whose gain would be merely temporary, the only people who would benefit by the subsidy would be the foreign purchaser of the gold . . .

To give more for an ounce of gold than it is worth in currency appears to us out of the question except on the supposition that we want gold for the purpose of keeping it locked up and

unavailable for export. We cannot, however, see any use in acquiring gold for such a purpose.

This passage seems, amid much that is admirable, to overlook one very important point. The depreciation of gold in terms of goods was due not to any sudden expansion in the gold supply but to the expansion of paper currency and bank deposits, i. e. to "inflation". Rising prices normally would decrease the supply of gold used as money material, by leading to its export and an increased use of it in the industrial arts. If, owing to the special circumstances of the war, such an alternative use was made difficult, and gold miners had to sell gold at the old "mint price" and yet receive only depreciated paper in exchange for it, the situation was not really the same as that contemplated by the committee. When they say that "to give more for an ounce of gold than it is worth in currency appears to us out of the question" it looks as if they were confusing the actual currency situation with the prewar one. *Then*, it was impossible, as they say, because the currency value of gold merely expressed the equivalent of the weight of bullion deposited. An ounce of gold, 11/12ths fine, was turned into £3.17.10½*d* and it would have been absurd to give more than this per ounce, because the only effect would have been to cause gold coins to be melted. But the value of gold in terms of paper currency *may* be more than £3.17.10½*d* if (a) gold coins cannot be melted down, (b) the quantity of paper goes on increasing. The premium on gold at any time is the difference between its purchasing power in a real gold-standard country and the actual exchange rate.

Under an arrangement with the Bank of England, gold producers sold their entire output to the Bank and the committee is concerned to show that (a) this arrangement was purely optional, and (b) that the terms were more favorable than the miners could have got in any other way. Finally they argue that the currency system does not operate unfairly;

there is one other matter on which we think it right to make some observations. There appears to exist a widespread impression that in some way the gold mine owner has suffered unfair treatment, that in the words of one of our witnesses, he has been damnified by the action of the government. It is apparently widely thought that he has been compelled to deliver the whole of his product to the government and that he has suffered by the issue of currency notes. It seems to us that had not the Bank of England been willing to take his products, he would have been unable to market them at all during the war, or at most to a very limited extent, and we have ascertained that so far from its being the case that any pressure was exercised upon him by the government he accepted readily an arrangement under which the Bank of England agreed to take the whole of his products. Further, the Bank took delivery of the products in South Africa at a standard price less an agreed charge for freight, insurance and refining, and other charges ordinarily borne by him, the agreed charges of 25 shillings per cent being much less than the charges he would otherwise have had to pay. The insurance alone would in 1917 to 1918 have amounted to five guineas per cent. On deposit of the gold in South Africa he obtained an advance of 98¾% of the value, thus gaining at least three weeks' interest. It is calculated that he saved by the arrangement some 3*s.* 4*d.* per ounce—a real benefit to him not in the least affected by the fact that the Bank were able to secure it for him, in view of the special arrangement they were in a position to make, without themselves incurring any additional expenditure in procuring the gold. Lastly, it was open to him at any time to cancel the arrangement. The Gold Producers have argued that the unavoidable expansion of currency by the issue of currency notes have raised prices against them unduly as against the producers of other commodities who have been able to obtain higher prices for their products, but it is to be remembered that the gold producers have always had the advantage of the standard price of their products during the periods when the price of other commodities have fallen. We cannot therefore agree that the sense of grievance is well founded in fact.

This is in substance to abandon the line of principle and to argue that the gold miner should have been content with the price which qua price he actually got. And in this sense no doubt the committee was substantially right, that is, in balancing a fixed price and smaller charges against a (higher) fluctuating price and heavier charges. It may be the case that the profit to the gold miner was not unduly small. But it is obvious that the special argument as to currency notes is not really on the same footing. Since the price revolution produced at least in part by inflation was so much greater than normal price changes, the principle of inter-temporal compensation hardly holds good.

After the armistice and the "unpegging" of the exchange, together with the embargo on gold, the situation became much clearer. With the pound sterling then worth only $4.20 it was obvious that by selling gold in London for paper the miners were losing about 60 cents per pound, minus the extra expenses they might incur by shipping to New York rather than to London. The result was that renewed pressure was brought to bear and a new agreement was negotiated with the Bank of England in July, 1919. We give the comment on this agreement of the *Economist* in its issue of July 26, 1919.

Belated justice has been done to the Transvaal gold miners by their being allowed to sell their gold in the best market. We understand that the gold will continue to come to London, but that export license will be granted so that its owners will be able to ship it to New York or Madrid, or wherever the exchange will enable them to turn it into sterling on most favorable terms. During the war most of the gold had been presumably sold abroad, but the government (presumably again, for the whole process has been wrapped in the deep mystery so dear to the official mind) took the profit on exchange instead of the mining shareholder. The effect of this new measure

on the exchanges thus does not seem likely to be very extensive. Presumably (we regret the frequent use of this ugly word, which is necessitated by official obscurity) the new arrangement will apply also to mines in Rhodesia and West Africa, whose gold has been commandeered by the treasury at the statutory price.

It is quite clear that the Committee were wrong in their main contention.

It was a principle generally accepted by governments in their price-fixing policies during the war to take into account increased costs of production. The British Government did this in fixing the prices of essential war materials. It was manifestly unfair to commandeer gold for war purposes and ignore this principle, although this was in effect what the Government did until it allowed the miners to sell their gold in the best market and convert the proceeds into sterling at the prevailing premium. That premium, and nothing short of it, was the proper compensation for the higher costs of gold production.

(2) *Stocks of Gold:* The second question is the stock of gold in the country. On this point conjecture is difficult owing to the absence of official import and export statistics for the last two war years, the uncertainty as to how much gold coin was in existence at the beginning of the war, and the extent to which gold had been hoarded. If an attempt is made on the basis of the available figures, the following conclusion is arrived at. On June 30th, 1914, the stock was:

	Millions
In the hands of the Bank of England[1]	£38.48
In the hands of the public and the joint-stock banks[2]	123.
	£161.48

[1] A small additional amount kept in the Banking Department is not considered here.

[2] First Interim Report of the Committee on Currency. Cd. 9182, par. 13.

Now, assuming that the public at the end of 1918 *held no gold hoard at all,* we would get as the gold holdings of the United Kingdom the following. The Committee on Currency and Foreign Exchange estimated the amount held by joint-stock banks in July of that year (1918) at £40,000,000. Therefore, on the further assumption that they still held at least that amount in December, 1918:

	Millions	
The Bank of England held	£78.6	(Return of Dec. 25, 1918)
The Currency Note Account held	28.5	
The joint-stock banks held	40.0	
	£147.1	

A net reduction therefore occurred in the gold holdings between June 30th, 1914, and December 31, 1918, of only about £15 millions. On the other hand Mr. Wm. A. Paton in his study on "The Economic Position of the United Kingdom 1912-1918"[1] estimates the net outflow, i. e. excess of exports over imports in the same period, at £120.5 millions. No unreported stock of bullion of this magnitude could possibly have existed in the United Kingdom at the outbreak of the war. The explanation lies in the gold output of the Empire as a whole. This amounted to:[2]

Year	*Millions of Pounds*	
1914	55.2	
1915	58.7	
1916	59.6	
1917	56.1	(Reckoning the oz. fine
1918	51.5 (estimate)	at £4.247 per ounce)
Total	£281.1	

There is nothing inherently improbable in the assumption

[1] Department of Commerce, *Miscellaneous series, No. 96,* 1919, p. 141.

[2] Figures taken from the Report of the Committee on Gold Production. Cd. 11, 1919, par. 4.

that about one-half of this gold should have been exported outside the limits of the Empire on account of the Bank of England. The amount produced in the period mentioned by the Transvaal mines alone came to £188.6 millions and this amount was, as has already been pointed out, sold entire to the Bank of England. Whether it was ever "imported" into the United Kingdom in the narrower sense to be subsequently reexported when it might have been sent to New York, say, direct from Cape Town is, of course, quite another matter. After the middle of 1916 the Bank published no further details of weekly gold movements, so that we are distinctly in the dark with regard to these matters.

III. FINANCIAL MOBILISATION PLANS

(a) Mobilisation of Securities

The history of the various schemes for mobilising foreign securities for the purpose of supporting the exchanges is complicated and can best be studied in connection with the various notices and orders emanating from the Treasury in connection therewith. Briefly put, mobilisation was voluntary until January 1917; thereafter full compulsion was applied.[1]

(1) On December 15, 1915, there appeared a notice to the effect that the Treasury was prepared to purchase American (including certain Canadian) dollar securities, or to receive such securities on deposit for use as cover for short loans to be contracted in America.

(2) On March 24th, 1916, the system changed and the scheme which subsequently became known as Scheme "A" was instituted. The first scheme had been quite successful

[1] A convenient summary will be found in the *Times Annual Financial and Commercial Review*, January 19, 1917, p. 2. See also Note (a) on p. 282 of the *Defence of the Realm Manual* (3rd edition revised to Feb. 28, 1917.

so far as amounts of stock bought were concerned; in fact, so far as the facts are known it seems that the "Government bought at a greater rate than the market in New York was prepared to absorb the stock and a considerable amount accumulated on the hands of the British Governments agents to be liquidated as occasion demanded.[1] As was more or less inevitable, however, the volume of sellers tended to diminish; consequently new steps were necessary.

Scheme "A": The essentials of the scheme were as follows:

(1) The range of securities was intended to include not only American securities, but also all other securities for which there was a market in New York.

(2) The price of the loan of the securities was to be ½% per annum on the face value of the securities and they might be retained for a period of two years.

(3) The Treasury reserved the right to sell the securities in which case the lender was to receive the New York price in sterling, plus 2½% on that value.

(4) The lenders retained the right to sell, receiving the price in sterling, and in case the Treasury sold, the original lender might buy back the securities by the payment of an equivalent amount in dollars.

Scheme "B": This scheme was again replaced in August 1916, by what has since become known as Scheme "B" (August 12, 1916). In order to force acceptance of Scheme "A", the penal income tax[2] had been introduced. Scheme "B" was intended to supplement the supply of securities which could be disposed of in the

[1] *Op. cit.*, note, p. 50.

[2] A penal additional Income Tax of 2*s*. in the £ on income derived from such securities.

New York market. The essence of the new scheme was as follows:

(1) Scheme "A" depositors might transfer to Scheme "B" by giving notice not later than September 14th, 1916.

(2) The scheme applied:
   a. To all dollar securities under Scheme "A".
   b. To all securities as might be announced from time to time.
   c. To those in the list annexed to the notice.[1]

(3) The period of deposit was to be five years from 31st March, 1917, "subject to the right of the Treasury to return them to the holders at any time on or after 31st March, 1919, on giving three months notice . . ." Consideration money for the deposit was continued at ½% on the face value of the securities and the depositor continued to receive all interest and dividends paid in respect of them. Subject to the right of sale, the securities would be returned at the termination of the period of deposit.

(4) The right of sale was reserved to the Treasury, but in this event, "the lender will continue to receive from the Treasury the same payments as he would have received if the securities had been retained, and at the end of the period of the loan, the Treasury will either return to him securities of the same description and to the same nominal amount as those originally deposited or, at their option, they will pay to him the deposit value of the securities with an addition of 5% on

[1] The listed securities included Argentine Government bonds, gold loans and Railway Loans; Funding Bonds of the same government; Chilian Government loans; certain Danish, Dutch, Egyptian, Japanese, Norwegian, Swedish and Canadian Government loans; Canadian and Argentinian Railway debentures and some municipal bonds (Copenhagen and Stockholm).

that value, plus accrued interest from the last preceding interest date."

On Tuesday, August 5th, 1916, it was announced that should the Treasury be under the necessity of exercising its right to sell any of the deposited securities—and the average price realized was more than the deposit value plus 5 per cent—the depositor would, if the securities were not replaced, at the end of the loan period receive the full amount of the average price actually realized.[1]

The New Schemes [2]

In the early days of 1917 (January 24, 1917) three new regulations under the Defence of the Realm Act appeared, of sufficient importance to bear quotation here:

Regulation 7, C.

(1) "Where the Treasury are of opinion that for the purpose of strengthening the financial position of the country, it is expedient that this regulation should be applied to any foreign securities, or to the securities of any concern owning or controlling any foreign securities, or any property or undertaking outside the United Kingdom or otherwise carrying on business wholly or mainly outside the United Kingdom, the Treasury may by

[1] Deposit value was defined in the case of sterling securities as the et mean quotation (i. e. ex dividend) on the London Stock Exchange f the day preceding the publication of the notice including the securities ı the treasury list for deposit under scheme "B", and in the case of ollar securities the sterling equivalent at the exchange of the day of he net quotation of the New York Stock exchange of that day. In he case of unquoted securities or quoted securities in respect of which he current quotation might not be regarded as representing the true ıarket value, the prices would be fixed by the Treasury. *D. O. R. Regns.*, rd edition, pp. 58-60.

[2] *D. O. R. Regns.*, 3rd edition, pp. 58-60.

order apply this regulation subject to any exceptions and conditions for which provision may be made by order, to any such securities specified in the order, whether the securities are actually in the United Kingdom or not.

Provided that no such order shall apply to any securities as to which the Treasury are satisfied that on the 24th day of January, 1917, they were beneficially owned by a person not ordinarily resident in the United Kingdom and that they remain so owned.

(2) The Treasury may take possession or require delivery of any securities to which this regulation is for the time being applicable on such terms as may be provided by the order under which the regulation is made applicable to the securities, and deal with them in such manner as they think fit, and the owner of any securities and any person who has any interest in or is the registrar of any such securities, shall take all steps and do anything which is necessary or is directed by the treasury for the purpose of, or in connection with, transfer or delivery of those securities to the treasury.

A certificate signed by a secretary to the Treasury that any securities particulars of which are given in the certificate have been taken possession of by the Treasury shall be taken as conclusive evidence of the facts stated in the certificate by the registrar of any securities.

(3) Provision may be made by an order under this regulation for any case in which securities transferred or delivered to the Treasury are subject to any mortgage or other charge by substituting for the mortgage or charge on the securities, a mortgage or charge on any payment made or other

consideration given in respect of the transfer or delivery of the securities.

Any order of the Treasury under this regulation might be revoked or varied as occasion required.

Regulation 7, D.

(1) A person shall not without the consent of the Treasury remove from the United Kingdom or be directly or indirectly concerned in removing from the United Kingdom any securities to which the Treasury have power to apply or have applied Regulation 7C, or dispose of any such securities to any person except to a person ordinarily resident in the United Kingdom.

(2) The Treasury may, by notice published in the London, Edinburgh, or Dublin *Gazettes*, require the owners of any securities to which the Treasury have power to apply Regulation 7C, or have applied that regulation, to make a return to the Treasury, giving such particulars as to those securities within such period as may be specified in the notice, and owners of those securities shall make a return accordingly.

Regulation 7, E.

Regulation 7E defined the term securities for the purposes of the above and the term "owner" of such securities and laid down penalties for a breach of the regulations.

In a notice dated January 25th, 1917, the Treasury foreshadowed the issues of orders under authority of the above Regulations. The notice saliently states the procedure upon which the authorities intended to proceed:—

Compensation for securities requisitioned will be granted on the principle which has up to the present been applied in fixing the price paid for securities voluntarily sold to the Treasury—

that is to say, where entire ownership is required by the Treasury, the capital value of the securities based on current market prices will be paid. Where temporary use of the securities only is desired the interest or dividends on the securities will be paid to the former holders with an addition of ½% per annum, calculated on the nominal amount of the securities.

If full ownership is subsequently required of securities taken in the first instance for temporary use, the compensation payable when full ownership is taken, will be based on the capital value at the date of original requisition or at the date of taking over of full ownership, whichever may be higher, but no additional allowance will be granted such as that provided for under the purchase clause of the existing deposit schemes.

Securities already deposited into the Treasury under Schemes "A" and "B" or under special arrangements, will not at present be requisitioned, but will remain subject to the conditions of of those schemes.

These orders made necessary that the Treasury define the conditions under which sales of securities should in future be permitted and a notice on this subject dated January 30, 1917, immediately followed. Under this notice dollar securities could be sold only in the U. S. A., Canada and Newfoundland; securities of other countries might be sold in such other countries, but proceeds of sale were to be remitted to Great Britain.

No further useful purpose would be served by enumerating the orders which followed—they only list the securities requisitioned in great detail and particulars will be found in the various editions of the Defence of the Realm Manual.[1] The quantity of securities not merely requisitioned but actually sold was given in a report of the American Dollar Securities Committee in December 1919.[2]

[1] *D. O. R. Manual*, 3rd edition, pp. 267-301.

[2] The report stated that of the American Dollar Securities, amounting

With the opening of the year 1919, the activities connected with the control of American securities practically ceased. " The Lords of the Treasury also give notice that as from January 1st, 1919, no further purchases of securities will be made by the American Dollar Securities Committee. This notice does not apply to such holdings as are due to be delivered under the Treasury (Securities) Order Nos. 1-4 (1917) or to securities held on deposit under Schemes " A " and " B " for which prices will be quoted on application to the American Dollar Securities Committee as heretofore ".[1] At the same time Regulation D quoted above limiting the sale of securities abroad was modified, permitting the sale abroad,

until further notice of any foreign, colonial or Indian securities to which the Regulations relate (whether or not the securities have remained in physical possession in the United Kingdom since September 30th, 1914,) and the shipment abroad of the securities in completion of any such sales, subject to the following limitations and conditions:

(1) Such permission shall apply only to securities which have not at the time of sale been included in any order issued by the Treasury under the Regulations.

(2) The proceeds of any such sales shall be remitted to this country forthwith and retained here.

(3) The proceeds of drawn securities or maturing securities collected abroad shall be remitted to this country

to £250,543,000, which came into the possession of the treasury, £177,614,000 or 71 per cent, were purchased for resale in New York and £72,928,000, or 29 per cent were still held by Great Britain. Since that date the additional special Income Tax of *2s.* in the £ was discontinued as from the 6th April, 1919, the purchase by the Treasury of deposited securities was discontinued on the 28th April and, the required three months' notice having been given, the return of registered stocks to the amount of £67,615,000 commenced on 1st April.

[1] *Lloyds Bank circular*, Feb., 1919, p. 52.

forthwith and retained here in the same manner as the proceeds of any sales of securities.

(4) All existing Regulations in regard to dealing with securities which have not been continuously in physical possession in the United Kingdom or which have been in enemy ownership or in which any enemy interest is concerned will continue to apply in full force to all dealings under this permission.

(5) Before any securities are sent abroad for requisition and return, a form of permit for the reimport of such securities must be obtained.[1]

The mobilization of foreign securities was primarily for the purpose of augmenting the supply of credits abroad—particularly in New York—which was running low at the end of 1915. Gold shipments were inadequate and some other means of supporting the dollar exchange was imperative. The various schemes just described had for their general purpose the mobilization of British owned foreign securities in the hands of the Treasury. Securities were borrowed with options of purchase and until January, 1917, inducements in the form of interest premiums, etc., were offered for the voluntary turning over of the desired securities by the holders. After January, 1917 the element of compulsion was introduced and penalties in the form of special taxes were placed on such securities. The government sold some of these securities outright in New York and used others as collateral for loans placed there. It was mainly through these mobilization schemes that the "pegging" of sterling exchange in New York was made possible. These schemes served their purpose until the entry of the United States into the war in April, 1917, when ample credits for the maintenance of the "peg" became available from the United States Treasury.

[1] *Lloyds Bank circular*, Feb., 1919, p. 52.

(b) *The Embargo on Fresh Capital Issues*

The requisition of already existing property in foreign securities for the purpose of supporting the exchange is only one aspect of financial mobilisation. From an early period in the war a series of measures were taken for checking the flow of capital into directions deemed undesirable. These measures fall into two different categories; the withholding of financial facilities, and the prohibition of the export of capital; and the creation of differential rates for money. In this section the first of these categories will be examined.

(1) As early as January 19th, 1915 [1] the Treasury announced its plan of campaign. On that day there appeared in the Press a notice which set forth that in view "of the paramount necessity of husbanding the financial resources of the country with a view to the successful prosecution of the war", the Treasury felt it imperative "that fresh issues of capital shall be approved by the Treasury before they are made."

The principles upon which the Treasury intended to proceed were as follows:

(a) Issues for undertakings carried on or to be carried on in the United Kingdom shall only be allowed where it is shown to the satisfaction of the Treasury that they are advisable in the national interest.

(b) Issues or participations in issues for undertakings carried on or to be carried on in the British Empire overseas shall only be allowed where it is shown to the satisfaction of the Treasury that urgent necessity and special circumstances exist.

(c) Issues or participations in issues for undertakings carried on or to be carried on outside the British Empire shall not be allowed.

[1] See *Defence of Realm Manual* (Financial Edition), June, 1915, XI Restrictions on Fresh Issues of capital, p. 181 *et seq.*

(d) The Treasury will not in ordinary cases insist upon the above restrictions where issues are required for the renewal of treasury bills or other short instruments held here and falling due of foreign or colonial governments or municipal corporations or railways or other undertakings."

On January 27th, 1915, an announcement was issued, intimating the appointment of a committee "to consider and advise upon applications received by the Treasury for approval of fresh issues" on which sat several well known financial men including the governor of the Bank of England, and a representative of the Board of Trade. In order to define the scope of the work, a further notice issued on January 29th stated that "the approval of the Treasury should be obtained for *all* fresh issues of capital of whatever nature, whether made on behalf of a government, municipality or other public body, or any company, whether public or private."

On March 25th, 1915, a letter addressed by the local government board to local authorities intimated that the sanction of the board to borrowings given after March 12th, sufficed unless the money proposed to be raised was to be raised otherwise than by the issue of stock, bonds or bills, which required Treasury consent, whilst sanctions given before March 12th required a further board or treasury sanction, according to the circumstances of the case. It was further suggested that in any future application, local authorities must furnish proof that borrowings were required for works "of pressing necessity either for reasons of public health or on account of war requirements" and these terms would be "construed in their strict sense" by the Board. The whole of this policy was without legal foundation and it was stated in answer to a question addressed to the government in the House of Commons on May 18th, 1915, that no further legal powers were at that time contemplated, the government considering it probable "that

in present circumstances promoters will not persist in propositions of which the Treasury have expressed disapproval, or that if they do persist that such propositions will be supported by the public. Should they do so, the question whether any advantage they may thereby obtain over those who have been content to be guided by the rules laid down, should not be counter-balanced by special fiscal burdens, will not fail to receive careful consideration."

(2) An embargo on capital issues without Treasury consent could not of course check the export of capital in the sense that private individuals could not still remit funds abroad for investment purposes.

A considerable period of time elapsed however, before compulsion was applied in this direction. On November 27th, 1917, there was issued Regulation 41 D under the defence code which ran as follows:

A person resident in the United Kingdom shall not, without permission in writing from the Treasury, directly or indirectly, either on his own behalf or on behalf of any other person resident in the United Kingdom.

(a) Send any remittance out of the United Kingdom for the purpose of:

1. Making a subscription to any loan or subscribing to any issue of capital outside the United Kingdom; or
2. Purchasing any stock shares or other securities or any property other than merchandise, if the securities or property are not in the United Kingdom; or
3. Purchasing any foreign currency to be held with a view to appreciation in value or as an investment; or

(b) Take part in, or agree to offer to take part in, any of the above mentioned transactions if such transactions involves the sending of any remittance out of the United Kingdom.

Any banker or person acting in any similar capacity shall, as a condition of sending out of the United Kingdom any remittance on behalf of any person resident in United Kingdom, require the person resident in the United Kingdom to make a declaration in writing as to the purpose for which the remittance is proposed to be sent. In any proceedings under this regulation any purchase or agreement or offer to purchase foreign currency shall be deemed to be for the purpose of holding the same with a view to appreciation in value or as an investment unless the contrary is proved.

Any reference in this regulation to the sending of a remittance out of the United Kingdom shall be *deemed to include a reference to placing money in the United Kingdom at the disposal of a person not resident in the United Kingdom.*

(3) *Position after the Armistice:*

Early in the year (1919) the position as to the control of capital issues was considerably altered. The old form of treasury control was changed, but the definitive form of the new control was only decided after a sharp conflict of opinion between the government and the city. Towards the end of February, 1919, the government announced in the House of Commons the reconstruction of the Committee on New Issues, its function being to "consider applications for fresh issues of capital with a view to preserving capital during the reconstruction period for essential undertakings in the United Kingdom and to preventing any avoidable drain upon foreign exchange by the export of capital." From the first this "continuation of coddling control" as the *Economist* called it was unpopular, but when the government proceeded to issue a new Defence of the Realm Regulation, requiring all issues to be licensed with heavy penalties for trespass, City opinion was so hostile that the government had to climb down. The obnoxious regulation was

withdrawn and replaced by order 30 F. which runs as follows:

(a) It shall not be lawful, except under and in pursuance of a license granted by the Treasury:

1. To issue capital in the United Kingdom where the proceeds of the issue or any part thereof are to be applied for capital purposes outside the United Kingdom, or to replace money which has been so applied; or
2. To issue capital in the United Kingdom or to renew or extend the period of maturity of any security where the issue renewal or extension is made by or on behalf of a person not ordinarily resident in the United Kingdom:

Provided that the foregoing prohibition shall not apply to the issue of shares of an amount not exceeding £100 in all to the subscribers of a memorandum of association:

(b) Every prospectus or other document offering for subscription any stock, shares or securities, shall include a statement that no part of the proceeds of the issue is to be applied for capital purposes outside the United Kingdom or to replace money which has been so applied, or in cases in which the proceeds of the issue are to be applied for capital purposes outside the United Kingdom or to replace money which has been so applied that the necessary license has been obtained from the Treasury;

(c) For the purposes of this regulation:

A person shall be deemed to issue capital who:

1. issues (whether for cash or otherwise) any stock, shares or securities, or:
2. pays or receives any money or loan on the terms expressed or implied that the money is to be or may be applied at some future

date in payment of any stock, shares or securities to be issued at whatever date to the person making the loan.

The expression "securities" means bonds, debentures, debenture stock and other marketable securities.

(d) No person shall, except under and in pursuance of a license granted by the treasury

1. buy or sell any stock, shares or other securities except for immediate payment, or (in cases where the purchase or sale takes place in any recognized Stock Exchange) subject to the rules or regulations of such exchange; or

2. buy or sell any stock, shares or other securities which have at any time since the 30th September, 1914, been in physical possession outside the United Kingdom.

(e) Notwithstanding anything in this regulation a person may without a security license from the Treasury issue a security (being a security, the issue of which would otherwise be prohibited by this regulation) where the issue is solely for the purpose of securing an overdraft or the repayment of a debt contracted or to be contracted in the ordinary course of trade, but a person shall not transfer or accept a transfer of any security so issued without a license under and in pursuance of a license granted by the Treasury.

It will be seen that, logically enough, the new Regulation affected not only capital issues but also the dealing in such issues. The embargo on fresh capital issues had for its purpose not only the control of the financial resources of the country for war activity and the prevention of competition with the government by non-war enterprises, but also the prevention of the export of capital, with consequent drain

CAPITAL ISSUES IN THE UNITED KINGDOM 1914-19[1]
(Capital applications on London Money Market)
(*figures in Millions of £*)

Category	Year					
	1914	1915	1916	1917	1918	First half 1919
British Government Loans..	332.5	614.3	554.1	1297.8	1343.0	324.1
Colonial Loans............	38.7	17.4	6.5	13.9	4.8	3.0
Foreign Loans	18.3	35.5	15.0	nil	14.8	nil
British Municipal Loans	3.1	nil	.5	nil	1.0	nil
Colonial Corporations	7.8	.4	nil	nil	nil	nil
Foreign Corporations	10.6	nil	nil	nil	nil	nil
British Railways	2.2	3.3	1.7	nil	nil	nil
Indian and Colonial........	23.4	4.0	nil	nil	1.0	nil
American Loans	1.4	nil	nil	nil	.8	nil
Foreign	12.8	2.9	.4	nil	nil	nil
Mining Companies:						
Australian	.6	nil	*—	nil		
South African	.3	nil	nil	nil	.3	2.0
Other Mines	1.8	*—	*—	nil		
Exploration and financial ...	5.1	*—	nil	nil	nil	3.7
Breweries and distilleries....	.9	nil	nil	nil	nil	
Merchants, etc............	.3	nil	.1	nil	nil	.6
Manufacturing	8.0	1.8	1.5	1.4	4.3	10.1
Stores and Trading	2.3	nil	nil	nil	nil	.8
Estate and Land	3.0	*—	nil	nil	nil	.2
Rubber	.7	.2	*—	*—	nil	.6
Oil	3.4	*—	1.6	1.1	1.7	.3
Iron, Coal, Steel, etc.	3.7	.2	1.6	.9	11.5	7.0
Electric lighting, power, telegraphs, etc............	6.7	.5	.1	.2	2.1	1.6
Tramways and Omnibus	5.9	.4	nil	.1	.1	nil
Motors	1.6	.1	.4	.6	.7	4.5
Gas and Water............	.7	*—	*—	nil	.1	*—
Hotels, theaters, etc..	.8	.1	do	nil	nil	2.3
Patents	.4	nil	do	nil	nil	.4
Books and Shipping........	7.2	.6	.8	nil	.1	.3
Banks and Insurance	3.5	.3	.3	1.5	2.8	11.6
Miscellaneous	5.1	.3	1.3	1.2	4.4	12.9
Total Exclusive of Government Loans......	180.1	71.0	31.5	40.9	50.5	61.9
Grand Total	512.6	685.3	585.6	1338.7	1393.5	386.0

(*—insignificant)

[1] Figures compiled from various issues of the *Economist* from 1914 to 1919, inclusive.

on the exchanges. It was therefore supplementary to the security mobilization schemes described above. Briefly, the embargo was made operative through a Treasury permit system on all new issues of capital, and a Treasury committee was empowered to pass on all applications. Moreover, Treasury consent had to be secured in order to subscribe to foreign loans, to buy foreign securities, or to buy foreign currencies for any purpose other than the purchase of merchandise. After the Armistice the method of control changed somewhat, but the general intent remained the same, namely, to conserve capital for essential post-war rehabilitation.

As will be evidenced by the table on page 65, the distribution as well as the amount of new issues appreciably improved, although government issues were still by far the most important form of new issues during the first half of 1919.

(c) Differential Rates for Money.[1]

A further aspect of the financial methods pursued during the war deserves special mention. This is the differentiation of rates for money deposited by different types of customers. The lowering of the rates on general deposits put pressure on depositors to invest in higher interest bearing directions—in particular government securities. By offering interest where none was offered before, the Bank of England obtained a firmer grip on the money market; by differentiating between home and foreign money the Bank improved the exchange situation and at the same time reduced the cost to itself and diminished the pressure to invest in other directions.

(1) *Reduction of Rates to General Depositors:* In general,

[1] Compiled from the Annual Banking Numbers & Commercial History numbers of the *Economist*, except where otherwise stated.

the rate on deposits subject to notice is fixed by the joint-stock banks of the clearing-house groups at 1½% below bank rate. In the Banking number for May, 1915, the *Economist* reviewing the situation for 1914 states that "the figures for the second half of the year reflect still more the abnormal state of affairs, for the average deposit (rate) of £2.10.0 is no less than £2.6.10 below average bank rate, bankers having entirely abandoned the custom of regulating the rate in accordance with the official minimum." For the year 1915, the Commercial History number states that "the average deposit rate for the year was £2.12 per cent. During the first half of the year it remained at 2%, no less than 3% below bank rate. But with money at such cheap rates, the joint-stock banks naturally departed from their usual custom of paying interest upon deposits at 1½% below bank rate." The matter was again referred to in the *Banking Review* for 1915: "the banks have abandoned their practice of paying interest at the rate of 1½% below bank rate, the margin between the two working out at nearly 2½%. . . ." In 1916, the average Bank rate was £5.9.3 and the average deposit rate was £3.14.4 a difference of £1.14.11—bank rate being 5% January to June; and 6% July to December. The *Banking Review* explained the margin by saying that "It is the practice of bankers not to pay more than 4% on deposits no matter how high Bank rate may go." The margin was therefore 1½% in the early part of the year and 2% in the later months. In 1917, Bank rate for the greater part of the year was 5% (April to December; falling from 6% in January to 5½ in February and March) but the deposit rate stood unchanged throughout the year at 4%, so that the average below bank rate was £1.3—less than 1½%. In 1918, however, the system, up till then regulated by the self-interest of bankers, became part of the regular machinery of financial mobilisation. Bank rate remained

steady at 5% throughout the year, but states the *Commercial Review* "in the first half of the year treasury conferences with bankers resulted in a reduction of the maximum rate offered by the banks on deposits to 3%, this device being designed to divert more public money into the National War Bonds." The margin was thus widened to 2% (the rate was lowered ½% on January 2, 1918 and another ½% on February 14th, 1918). Thereupon no further change took place until October 11th, 1919, when, Bank rate still being 5%, but the Bank of England no longer paying for banker's deposits, the deposit rate was raised to 3½%.

(2) *Banker's Money at the Bank of England:* The Bank of England until the outbreak of the war paid no interest on its deposits and this practice was continued in the first year and a half of war. But, says the *Banking Review* for 1916 "the clearing banks have further under a new arrangement made in March 1916, been able to deposit money at fixed interest with the Bank of England, withdrawable at three days' notice". The effect of this was at once seen to be that by means of it (a) the Bank of England controlled the market rate, for it virtually established a minimum below which lenders would not advance; (b) by increasing direct control of funds by the Bank "the interest rate allowed by the Bank of England on bankers' spare balances has practically displaced the official minimum discount rate as the governing factor in the money market." In the first year of the working of the system down to the middle of July, the interest rate varied from 4 to 4½%; from thence to the end of the year the rate was 5%.[1] The position during 1917 was as follows:—

During the second week in January, 1917, after the cessation of

[1] These details are taken from the British Association reports for 1917, published as "Industry and Finance," p. 209.

sales of Treasury bills, it was announced that the Bank of England was prepared to take spare balances from the Scottish and Colonial banks as well as from the Clearing Banks, the rate (for spare balances from the Scottish and Colonial banks) being 4½% to 5%, according to the currency of the loan. On Monday 26th February, the Bank of England again altered the rate it was allowing for spare balances from other banks, making it 4½% in the case of the clearing banks and 4 and 4½% in the case of other banks, according to the currency of the loan. Although the Bank rate was reduced from 5½% to 5% on Thursday 5th April, 1917, no change was made by the Bank of England in the special deposit rate for bankers' spare balances. On Tuesday June 19th, however, the special deposit rate for bankers' spare balances was again reduced to 4% in the case of the clearing banks and to 3½% in that of other banks, which rates were still in force at the end of the third year of the war. In 1918 again a change was made, rates being reduced by one half per cent to 3½% with a further reduction of ½% on February 14th.

No further change seems to have been made up to the time of ending of the system altogether, of which a word will be said below.

(3) *Differentiation between Home and Foreign Balances:* The year 1918 witnessed the inauguration of a differentiation between home and foreign balances deposited at the Bank. The object was a twofold one, to promote the policy of investing in government securities any spare money available, and to keep up the rate on foreign balances, diminishing the temptation to remove balances abroad, thus reducing the strain on the exchanges. It was in fact an attempt to reintroduce the idea of an elastic bank rate to improve the exchange without causing pressure on internal monetary debtors. Thus when in January and February the rates on home money were lowered "on foreign deposits the Bank of England offered on the other hand, a steady rate of 4½%

throughout the year." In January, 1919, an important distinction was made between allied and neutral balances, the announcement being made on January 8th,

> that the special rate of 4½% given just over a year on deposits of foreign money would no longer apply to French, Belgian and Italian money deposited with the Bank. The reason for the alteration is to be found in the exchange situation, and the fact that it is no longer desirable that attractions should be offered to keep such deposits here. On the contrary, from the point of view of our Allies it is the exact opposite, that is undesirable, and it is of far greater importance in the interests of all the Allies, including ourselves, to assist in the stabilisation of the exchange.[1]

The Bank of England entirely discontinued payment of interest on home balances on July 31, 1919, and on foreign balances October 20th of the same year.

(4) *The Post Armistice Period:* The question of the permanent differentiation between home and foreign money had been discussed by the Committee on Currency and Foreign Exchanges after the War, and the argument presented to them in favor of the proposal, that it would "keep money for home industry substantially cheaper in this country than it was abroad and yet retain an effective gold standard", had been adversely commented upon.

> In our judgement, so soon as the present obstacles in the way of international intercourse are removed, any attempts to maintain this differentiation must break down because it would be impracticable to prevent people from borrowing at the low home rate and contriving in one way or another to relend at the high foreign rate. This could only be prevented if at all, by the maintenance of such stringent restrictions upon the freedom of investment after the war as would, in our opinion, be most

[1] *Lloyds Bank Circular* for February, 1919, p. 76.

detrimental to the financial and industrial recovery of this country. Even, however, if differentiation, as a post war policy, were practicable, it would not, in our judgement, be desirable, for the low home rate, by fostering large loans and so keeping up prices would continue to encourage imports and discourage exports; so that, even though the high rate offered for foreign money prevented gold from being drawn abroad, it would only do this at the cost of piling up an ever-growing debt from Englishmen to foreigners. It would be necessary at the same time to continue to pay for our essential imports of raw materials by borrowing in the United States and elsewhere instead of increasing our exports, thus imposing further burdens of foreign debt. This process could not continue indefinitely, and must sooner or later lead to a collapse. We are, therefore, of opinion that the need for making money dear in the face of adverse exchanges, cannot and should not be evaded by resort to differential rates.[1]

Any attempt to subsidize the domestic producer through lower rates than were justified by the general economic and financial position of the country would, as in the case of any subsidy, result in the first instance in the burden being borne by some other part of the economic machine—in this case the exporting groups — and ultimately by the whole machine. No more can a country than an individual lift itself by its own boot straps!

IV. FINANCIAL MOBILIZATION SUMMARIZED

There have been outlined in this chapter the various measures which had as their purpose the financial mobilization of the country for the prosecution of the war. These measures were, in the first instance, for the protection and assistance of the bill brokers, the discount and acceptance houses, the banks(as holders of bills), and the Stock Exchange. The bill brokers and discount houses carry on their business

[1] Cd. 9182, par. 19.

for the most part with "day to day" funds advanced by the joint-stock banks. The calling of these loans because of credit stringency at the outbreak of the war forced the bill brokers and discount houses to have recourse to the Bank to an extent which taxed its resources and brought about the 10% rate. The moratorium on bills relaxed the tension at the Bank pending the issue of emergency currency and the easing of credit.

The embarrassment of the acceptance houses due to the breakdown of the exchanges and the difficulties of securing remittances from abroad to liquidate maturing acceptances was relieved by provision for the Bank of England to "carry" acceptors at 2% above Bank rate until one year after the war if necessary.

In order to start the wheels of commerce going again after the beginning of hostilities, provision was made for the joint-stock banks, with the assistance of the Bank if required, to put the acceptance houses in funds where remittances to meet maturing bills were delayed by war conditions.

The Stock Exchange, after being closed for three months, was taken care of by arrangements for advances of 60% of the value of securities by the Bank. Repayment was not to be pressed for until one year after peace was effected, and interest on the advances was to run at 1% above Bank rate.

These measures, essentially designed to relieve and assist the financial institutions of London, were made possible to a very great extent by the provisions of the Currency and Bank Notes Act, which have been discussed at length in this chapter, and which put the Bank of England in a position to supply currency and credit without stint and practically without limit.

The efforts to conserve gold by withdrawing it from circulation, preventing its export except by the Bank, and mobilizing it for reserve have been described. There have also been

outlined the various schemes for mobilizing foreign securities to bolster up sterling exchange; the embargoes on new capital issues to conserve financial resources and prevent money outflow; the control and lowering of interest rates to bank depositors for the purpose of diverting funds into government borrowings; and the preferential rates on foreign deposits to encourage the maintenance of foreign balances in London with the strengthening of the exchange in view. Financial mobilization could hardly have been more comprehensive, or controls more complete. There will be taken up in the next chapter the problems which the government had to face in the matter of greatly increased taxation to finance the war.

CHAPTER II

Government Revenue

Government revenue, in the broad sense, is the total income received by the government, which includes the proceeds both from taxation and from loans. In a more restricted sense, government revenue is that part of the government's income which is derived from various forms of assessment and on which there is no obligation of repayment. Loans imply such obligation, and have, moreover, a definite relation to future taxation and expenditure through interest and amortization charges. The discussion in the present chapter will therefore be concerned with revenue as derived from taxation. In Chapter III the subject of government borrowings will be considered separately. Little need be said on the subject of government expenditure during the war period, since a national emergency dictated such expenditure. War expenditure is at best essentially nonproductive and for this reason challenges the normal canons of appraisement. Outlay and cost of operations were secondary to results obtained in the most expeditious manner. Only the most general principles of efficiency could be applied, and these without regard to national economy in the peace-time meaning of the word. The one controllable factor in war-time cost is monetary inflation, which adds so greatly to the repayable part of the expenditure, i. e., the loans. The subject of monetary inflation is discussed at length elsewhere, and need not be elaborated here. Aside from this, government war-time expenditure cannot be given that close check and scrutiny which it would receive in the

study of a country's fiscal statement for a peace-time period. There was undoubtedly excessive expenditure after the armistice, due to war spending habits and to the fears and uncertainties which remained for some time after hostilities ceased. On the whole, however, war expenditure need command little of our attention. We are far more concerned with the financial burdens which the war period brought about, and the relation of war borrowings and taxation to those burdens.

It is clear that the greater the percentage of funds for outlay that can be raised through taxation by a country in time of war, the less will be the fiscal and taxation burdens in the years that follow. Great Britain, during the period from August 1st, 1914, to September 30th, 1919, raised only 30.5% of its income by taxation. In other words, for the war years and the year following, it financed itself by borrowings to the extent of approximately 70%. With war costs aggregating between 35 and 40 billion dollars, it can readily be seen how heavy must be the country's taxation burdens for many years to come. It is notable that after the fiscal year ending March 31, 1917, the percentage of taxation steadily increased, and was 62.7% in the post-armistice period from April 1st, 1919, to September 30th, 1919.[1] It is particularly regrettable that a larger percentage of funds was not secured by taxation for the fiscal years ending 1916 and 1917, when this percentage averaged less than 22%, for it was in these years that scarcity was greatest and price controls less stringent. More rigorous taxation would have partially off-set the effects of the scarcity and lack of price control. For there was in these years greater facility for passing on the tax in the form of higher prices than existed at a later date, when production was better organized and prices better controlled. As it was, price increase was facili-

[1] See table on p. 80.

tated at a time when its cumulative effects made it most serious from the standpoint of costs for the war period as a whole.

The Income Tax was the principal source of taxation revenue, yielding for the period up to September 30th, 1919, 31.4% of the tax revenue. Excess profits taxes were second in importance during the later years of the war. Because these taxes were not imposed until the fiscal year ending March 31, 1917, their percentage of total yield was somewhat less than that of Customs and Excise, being 21.9% as compared to 22.5% for the latter. Their total yield for the last war year, however, was considerably in excess of that from Customs and Excise. The Income Tax, the Excess Profits Tax and Customs and Excise duties yielded in the last two war years a little over 80% of the total revenue.[1] Revenue figures for the first full post-war year are somewhat misleading because large sales of war stocks were credited to revenue. Aside from this, however, taxes increased greatly without increase in rates.[2] This was particularly the case with Customs and Excise, due to the removal of war trade restrictions on imports and to post-war business activity. The latter also explains the large increase in Income Tax returns. Excess Profits duties showed a small increase, despite the fact that the rate was reduced from 80% to 40% for part of that fiscal year.

The present chapter includes a summary of war-time taxation, with tables showing total exchequer receipts, receipts from various sources, percentages of return, and segregation of returns under the various items of tax. It also contains a history of the various taxes during the war, with some discussion and criticism of the Excess Profits Tax and the general taxation policy of Great Britain during the war.

[1] See Table II, p. 78.

I. SUMMARY

THE following table shows for the six fiscal years ending March 31st, 1914 to March 31, 1920, Exchequer Receipts from the financial sources of revenue. A word of caution is necessary as to the meaning of this phrase. It describes the *actual* receipts of the British Exchequer during the financial year, which closes at 12 P. M. on March 31st of each year. Consequently, receipts properly belonging to that year may be excluded as not having been received prior to the closing of the books on March 31st. Subsequently readjustments both for receipts and repayments will have to be made so that the Exchequer Receipts do not present an authoritative account of the net revenue of the year, but only of receipts and payments in the course of that year. It follows also that there will be discrepancies between (1) the Exchequer Receipts from a Department and (2) the receipts of a Department in that year: and between the receipts of a Department and the final revenue collected by that Department. This explains the differences in the published figures from time to time, which unless understood lead to incorrect inferences as to the accuracy of governmental statistics.

The figures of main tax revenue have been set out in Table I—the other items lumped together under "all other revenue" have been so treated because they either do not represent net revenue (Post Office Receipts) or are relatively small items of very diverse kinds. It will be seen that the Income Tax held first place; the amount brought in by this tax (including the super tax) was about 50% greater than the yield from excess profits, which, however, was only imposed fully in the last three war years.

Table II summarizes the same facts from the viewpoint of percentages. It shows how much each of the principal sources of revenue yielded in the period mentioned.

TABLE I. "EXCHEQUER RECEIPTS" OF THE UNITED KINGDOM

(Value in £ Million)

Source of	1913–14	1914–15	1915–16	1916–17	1917–18	1918–19	1919–20
Customs	35.45	38.66	59.61	70.57	71.26	102.78	149.36
Excise	39.59	42.31	61.21	56.38	38.77	59.44	133.66
Total Customs and Excise	75.04	80.97	120.82	126.94	110.03	162.22	283.02
Estate duties	27.36	28.38	31.04	31.23	31.67	30.26	40.90
Income including super tax......	47.25	69.40	128.32	205.03	239.51	291.19	359.10
Excess profits including munitions of war levy	..	..	.14	139.92	220.21	285.03	290.05
All other "Revenue"[1]	48.59	47.94	56.45	70.31	105.81	120.32	366.50[2]
Total Revenue ...	198.24	226.69	336.77	573.43	707.23	889.02	1339.57

TABLE II. PERCENTAGE OF REVENUE REALIZED FROM UNDER-MENTIONED SOURCES 1913-14 TO 1919-20

Year	Customs & Excise	Death Duties	Income Tax	Excess Profits	All other Revenue	Totals
	%	%	%	%	%	%
1913–4	37.86	13.80	25.83	....	24.51	100.00
1914–5	35.71	12.52	30.62	....	21.15	100.00
1915–6	35.88	9.22	38.10	0.04	16.76	100.00
1916–7	22.14	5.45	35.76	24.40	12.27	100.00
1917–8	15.56	4.48	33.86	31.14	14.96	100.00
1918–9	18.25	3.40	32.75	32.06	13.54	100.00
1919–20........	21.13	3.05	26.81	21.65	27.36[2]	100.00

Table III shows in (1) the percental amount which each

[1] Includes: stamp duties, inhabitated house duty, net receipts crown lands, fee and patent stamps, the gross Post-office receipts, receipts by civil departments, etc.; proceeds sale of surplus war stocks.

[2] Increase of All Other Revenue and consequently of Total Revenue due largely to sale of surplus war stocks.

of the main sources of revenue yielded to the total revenue other than borrowings, and in (2) an index number of growth, from which it will be seen that the income tax yield grew much more rapidly than the total revenue.

TABLE III

(1) Percentage of Under-mentioned Sources of Revenue to total Revenue—Years 1913–14 to 1919–20

Customs and Excise	Death Duties	Income Tax	Excess Profits Tax	All Other Revenue
22.5%	5.2%	31.4%	21.9%	19.1%

(2) Index Number of Growth of Revenue 1913–14 to 1919–20[1]

Year	Customs & Excise	Death Duties	Excess Profits	Income Tax	All Other Revenue	Total Revenue
1913–14..	100	100	...	100	100	100
1914–15..	108	104	...	147	98	115
1915–16..	161	115	...	273	114	170
1916–17..	169	115	100	436	143	294
1917–18..	147	118	158	511	214	358
1918–19..	216	111	205	619	245	449
1919–20..	377	149	207	760	754	676

Table IV gives a summary of the relations between borrowing and revenue raising from the 1st of August 1914, a date which almost coincides with the entry of the United Kingdom into the war, to the 30th of September 1919.

[1] This table requires a word of explanation. The large increase in "All Other Revenue" in 1919-20 over the previous year is due to the placing in that category of sales of surplus war stocks—not properly revenue at all—referred to earlier in this chapter. The index number for "Excess Profits" has 1916-17 as a base instead of 1913-14 since this source of revenue first became important in that year. It is to be noted that the growth of revenue from this source between 1916-17 and 1919-20 was more rapid than from any other source except "Customs and Excise."

TABLE IV

Percentage of Revenue to Total Income of State
(i. e. Revenue and Loans)

Aug. 1, '14 to Mar. 31, '15	Apr. 1, '15 to Mar. 31, '16	Apr. 1, '16 to Mar. 31, '17	Apr. 1, '17 to Mar. 31, '18	Apr. 1, '18 to Mar. 31, '19	Apr. 1, '19 to Sept. 30, '19	Aug. 1, '14 to Sept. 30, '19
30%	22.5%	21.1%	26.3%	34.6%	62.7%	30.5%

It will be seen that the worst period from the standpoint of amount of income raised from revenue was the financial year 1916-17, while for the whole war period (down to June 30th, 1919) over two-thirds of the income of the State represents borrowed money. There was a great deal of discussion during, but particularly after the war, on the matter of government borrowing versus taxation. No less an authority than Mr. Hartley Withers told the writer that he believed that early in the war, Mr. Lloyd George could have secured public approval of possibly 75% taxation, so aroused were Britishers over the war and the danger of German invasion. He considered that the government's weakness had lost it the opportunity to minimize the post-war financial burdens. Even very conservative critics of the government estimate that probably 20% more taxation would have been possible without economic disturbance and impairment of production. The question is largely one of how far the British public would have gone in the matter of sacrifice of reward and gain for effort to prevent defeat. Conceivably a war could be carried on successfully by drafting the whole population and putting it on a military status. Under such circumstances public borrowing would be necessary only to the extent of purchases made abroad, i. e. requirements beyond the country's capacity to produce.

Table V gives the yield for the war period from Customs

TABLE V. NET RECEIPTS FROM PRINCIPAL HEADS OF CUSTOMS REVENUE[1]

(Value in £ Million)

Year	Cocoa, Coffee & Chicory	Currants, Raisins & Dried Fruit	Spirits, foreign & colonial	Sugar	Tea	Tobacco and snuff	Wine	Motor spirit	Cinema films	Motor cars and cycles	Musical instruments	Matches & mechanical lighters	Table waters and cider	Clocks and Watches	Other duties & receipts	Total
1913–14	.56	.51	4.44	3.27	6.50	18.26	1.15	.82	..	..	..	..	..	..	.05	35.57
1914–15	.60	.47	4.97	3.20	8.93	19.27	1.00	.94	..	..	..	..	..	..	.05	39.15
1915–16	1.05	.62	5.32	8.85	13.96	25.74	1.08	1.76	.18	.54	.07	..	..	.24	.15	59.58
1916–17	2.23	.54	4.17	17.95	14.31	27.34	.89	1.92	.17	.21	.07	.37	.01	.46	.05	70.71
1917–18	2.96	.23	3.48	15.07	12.52	33.29	.78	1.65	.15	.12	.06	.02	.01	.45	.10	70.89
1918–19	3.25	.28	5.58	27.01	16.05	46.23	1.41	2.16	.17	.19	.06	.32	.01	.66	.09	103.47
1919–20	3.15	1.05	16.16	40.88	17.74	60.86	2.24	2.99	.20	2.00	.24	1.09	.01	.92	[2]	149.55

NET RECEIPTS FROM PRINCIPAL HEADS OF EXCISE DUTIES

(Value in £ Million)

Year	Beer	Spirits	Railway duty	Glucose and Saccharine	Patent medicine	Playing cards	Liquor licenses	Other licenses	Matches & mechanical lighters	Table waters and cider	Entertain-ments	Other receipts	Total
1913–14	13.62	19.54	.29	.06	.36	.03	4.52	1.20	..	..	..	.04	39.66
1914–15	15.86	20.30	.26	.06	.33	.03	4.33	1.18	..	..	..	.07	42.42
1915–16	33.75	21.52	.26	.17	.63	.04	3.52	1.22	..	..	..	.10	61.21
1916–17	31.57	13.84	.27	.38	.73	.04	3.50	1.20	.65	1.23	3.01	.06	56.48
1917–18	19.11	7.11	[3]	.31	.80	.05	2.40	1.05	1.21	1.46	4.99	.07	38.58
1918–19	25.42	18.66		1.09	1.07	[4]	1.27	1.11	1.71	1.58	7.52	.09	59.66
1919–20	71.28	42.63		1.16	1.33	[4]	1.50	1.58	2.31	1.42	10.48	.04	133.78

[1] Figures from Statistical Abstract, U. K. [2] Deductions due to excess of amounts appropriated in the year over the amounts deposited. [3] As from Jan. 1, 1917, this duty has not been collected from Railways controlled by the Government. [4] After 1917 included under patent medicine.

and Excise Duties. The most fruitful source was still the tobacco and snuff duty, but the *rate of increase* of yield in some of the other duties, e. g. cocoa and coffee, sugar and tea, was greater than in the case of tobacco. The decline in the yield from beer and from spirits in the case of the excise duties was due to restrictions on consumption primarily and not to the heaviness of the duties, although this undoubtedly played some part. The high yield of the entertainments duty will also be noted.

Table VI (1) shows the development of the Income Tax during the war which may be useful as a supplement to the history of the tax rates which is given in a subsequent section. A word may be said as to the technical terms employed. The gross income brought under the revue of the Department gives the aggregate amount of income over which the Department exercised control in the year in question. From it must be deducted income belonging to individuals and corporations exempt because of the smallness of the income or the special nature of the body (Charitable Foundations, etc.) or because the recipient is non-resident in the United Kingdom, also allowances for depreciation, wear and tear, etc., which represent income not really " net ".[1]

The deduction of these amounts gives one the " Taxable Income " upon which, other things equal, tax may legitimately be collected. But the taxable income is further reduced by the special position of individuals, entitling them to consideration on account of the size of their income, the disposition of certain portions thereof (Life Insurance Premiums) or the claims on their income (Relief for Children). The deduction of these amounts gives one the amount upon which tax was actually received. The effective rate of tax

[1] Exempted income because it is below the minimum amount, is excluded from Schedule D, except in so far as incomes taxable at their source are concerned.

TABLE VI. (1) TABLE SHOWING FOR THE UNITED KINGDOM, THE GROSS INCOME FOR TAX PURPOSES, THE REDUCTIONS AND ALLOWANCES, THE INCOME ON WHICH TAX WAS RECEIVED, THE NET PRODUCE OF INCOME TAX AND THE AVERAGE EFFECTIVE RATE OF TAX LEVIED

Year	Gross Income £	[1] Exemptions and Reductions £	Actual Income £	[2] Allowances from Actual Income £	Income on which tax was received £	Net produce of tax £	Average effective rate of tax levied on each £ income d.
1913–14........	1,167.18	216.14	951.04	159.33	791.71	43.52	10.98
1914–15........	1,238.31	253.12	985.20	170.35	814.85	63.39	15.44
1915–16........	1,422.68	272.79	1,049.89	176.05	873.84	118.77	27.15
1916–17........	1,662.72	289.27	1,373.45	391.74	981.72	201.64	35.23
1917–18........	1,967.07	336.34	1,630.73	546.74	1,083.98	220.09	32.39
1018–19	2,445.66	374.08	2,071.57	784.29	1,287.28	303.63	35.17
1919–20........	2,970.60	423.42	2,547.18	1,130.96	1,416.22	336.56	31.71

[1] Includes income not exceeding the exemption limit; charities, hospitals, friendly societies, etc.; Dominion or foreign dividends belonging to persons not resident in the United Kingdom; repairs, lands and houses; empty property; wear and tear of machinery of plant; other reductions and discharges.

[2] Includes abatements; life insurance premiums; relief in respect of children.

on each £ of income (column 7) is the average rate on the taxable or actual income as distinct from the normal rate on the net income on which tax was received.

Table VI (2) gives budget estimates, amount paid into exchequer, etc.

TABLE VI (2)

BUDGET ESTIMATES, AMOUNTS PAID INTO THE EXCHEQUER, NET RECEIPT AND NET PRODUCE OF THE INCOME TAX

(Figures in Millions of Pounds)

Year (1)	Budget Estimate of amount receivable by Exchequer (2)	Amount paid into the Exchequer (3)	Net Receipt in the year (4)	Net Produce of each year's assessments (5)	Normal Rate of Tax in the £ (6)	[1]Produce for each penny of the rate of tax shown in column 6 (7)
	£	£	£	£	s. d.	£
1913–14..	42.70	43.93	43.90	43.52	1 2	3.11
1914–15..	53.02	59.28	59.42	63.39	1 8	3.17
1915–16..	99.82	111.56	112.37	118.77	3 0	3.30
1916–17..	178.00	185.93	186.54	201.64	5 0	3.36
1917–18..	205.90	216.25	214.86	220.09	5 0	3.67
1918–19..	255.75	255.59	257.71	303.63	6 0	4.22
1919–20..	312.00	316.93	317.03	336.56	6 0	4.67

The Schedules into which the sources of receipts are divided are as follows: Schedule A, income from ownership of lands, etc.; Schedule B, profits from occupation of lands; Schedule C, income from government securities; Schedule D, profits from trades, business, etc.; Schedule E, salaries of government corporation and public company officials. The very important Schedule D requires a word of special comment. This schedule not only contains receipts from home sources, but a considerable part of the income from

[1] This is derived by dividing the Net Produce of each year's assessments (column 5) by the number of pence in the normal rate.

foreign sources is included in this schedule. Hence it is a grave error to take Schedule C as indicative of the total income from abroad received by the Income Tax Commissioners. Of the portion included in Schedule D a certain amount is capable of accurate ascertainment, but another and important amount is included under the head of "Business, Professions", etc., not otherwise detailed. This unidentified amount includes:

(1) Concerns (other than railways) situate abroad but having their seat of direction and management in Great Britain, e. g., mines, gas works, water works, tramways, etc.
(2) concerns jointly worked abroad and in Great Britain, such as electric telegraph cables and shipping.
(3) Foreign and colonial branches of banks, insurance companies and mercantile houses in the United Kingdom.
(4) Mortgages of property and other loans and deposits abroad belonging to banks, insurance companies, land, mortgage and financial companies in the United Kingdom. Profits of all kinds arising from business done abroad by manufacturers, merchants and commission agents resident in the United Kingdom.[1]

Figures as to the identifiable portion under Schedule C given below in Table VII are taken from the Annual Reports of the Commissioners of Internal Revenue.

[1] For a critical discussion of the mistakes due to the confusion between the total income from, and the identifiable income from abroad, see Dr. J. C. Stamp's classical work *British Incomes and Property*, pp. 230-237.

TABLE VII

SHOWING IN A CONDENSED FORM THE INCOME TAX ASSESSMENTS ON THE INCOME FROM BRITISH, DOMINION AND FOREIGN GOVERNMENT SECURITIES

(Figures in millons of pounds)

Year	British	Dominions, etc.		Foreign				Total
		India	Other	European	Asiatic	African	American	
	£	£	£	£	£	£	£	£
1913–14..	13.70	9.71	16.11	1.94	3.69	.46	5.57	51.17
1914–15..	14.09	9.77	17.96	2.24	4.15	.62	5.17	53.99
1915–16..	32.50	9.85	18.94	..	10.48			71.77
1916–17..	54.86	9.69	18.95	..	11.76			95.26
1917–18..	35.31	9.77	18.92	..	12.60			76.61
1918–19..	43.55	9.58	19.24	2.19	2.28	*	3.31	80.15
1919–20..	54.56	9.43	18.79	2.98	2.20	*	3.20	90.46

(* negligible)

The index rate of growth of the income on which tax was received, 1913-19, was:

Year	*For all the schedules*	*For Schedule D*
1913–14	100	100
1914–15	103	103
1915–16	110.5	105
1916–17	124	118
1917–18	137	135
1918–19	162	162
1919–20	180	180

Finally as regards the super tax figures, it is sufficiently obvious that the change in the number of persons and the amount of income classified is one due to a change in the basis of the tax and not to a mysterious growth in the number of persons possessing incomes of over a given amount.[1]

[1] See Table VIII, p. 102.

II. INCREASE OF CUSTOMS AND EXCISE DUTIES

Reference to Table V will show what customs and excise duties existed before the war. It also gives the amounts realized in a pre-war year and indicates the increases as they took place with the progression of the war and the need of increased revenue. The table also indicates when and on what commodities new duties were placed. A word on the principal items is necessary.

(1) *Sugar:* There was no change until 1915-16. Then by Sec. 6 of the Finance Act (No. 2), 1915 duties as set out in Schedule 1, Part 1, of the Act were brought into force. The duties were again increased by the Finance Act 1916, Sec. 5, equivalent to a rise of 50% on the 1915 scale (Schedule 1, Part 1). They were increased by nearly 75% on the 1916 scale by the Finance Act of 1918 (Sec. 8 and Schedule 3) but suffered no further increase in the Finance Act of 1919.

(2) *Tobacco:* By Sec. 9 (1) (2) of the Finance (No. 2) Act 1915, certain additions were made to the Customs and Excise duties on Tobacco, which had not up to that time been increased above their pre-war level. These additions were doubled by Sec. 4 (1) and (2) of the Finance Act 1917, and by Sec. 7 of the Finance Act of 1918 a new integral scale of duties was promulgated.

(3) *Spirits:* War legislation began with a surcharge on immature spirits by Sec. 2 of the Finance Act 1915. The surcharges were not applicable to mixtures compounded or preparations which on importation were charged with duty in respect of the spirit contained in them, or used in their preparation or manufacture. If the mixture, etc. was one which was recognized by the Commissioners of Customs and Excise as being used for medical purposes, and where duties had been levied on spirits for medical or scientific purposes, the duties would on proof thereof be refunded.

If surchargeable spirits had been mixed with other spirit before June 17th, 1915, the blended spirit was not to be liable to surcharge.

The ordinary spirit duties were varied and the surcharges reenacted by Sec. 3 and Schedule 1 of the Finance Act 1918. In the case of compounds for medical and scientific purposes containing spirit, the relief from surcharge was continued and a rebate allowed of 15/3 or £1–6*d*, as the case might be, by Sec. 4 (1) (2) of the Act. By Sec. 3 of the Finance Act 1919 new scales were laid down for ordinary duties, and the *Excise Duty* on spirits (which had not been affected previously) distilled in the United Kingdom was fixed at £2–10–0 per gallon, and the surcharge for both Customs and Excise reenacted on the old basis.

(4) *Patent Medicines:* These duties, chargeable in a number of Acts were by Sec. 11 of the Finance (No. 2) Act 1915[1] doubled in amount, although the Act itself imposed only a surcharge on additional duties "of an amount equal in each case to that payable under the said Acts". The additional duties were to be continued until August 1st, 1920 by Sec. 2 of the Finance Act of 1919.

III. NEW CUSTOMS AND EXCISE DUTIES

(1) No *new* customs duties were imposed until the passage of Finance (No. 2) Act of 1915. By Sec. 12 of this Act the following duties were imposed:

A duty of 33⅓% ad valorem upon

- Motor cars, including motor bicycles and motor tricycles
- Accessories and component parts of motor cars, motor bicycles or motor tricycles other than tyres
- Musical instruments, including gramaphones, pianolas and other similar instruments
- Accessories and component parts of musical instruments and records and other means of reproducing music
- Clocks, watches and the component parts of clocks and watches.

(2) *Cinematograph films* imported for the purpose of the exhibition of pictures or other optical efforts by means of a cinematograph or other similar apparatus were taxable, per linear foot of the standard width of 1⅜ inch.

	d
Blank film, on which no picture had been impressed known as raw film or stock	0⅓
Positive, i. e. films containing a picture and ready for exhibition	1
Negatives, i. e. films containing a photograph from which positives can be printed	5

The basis of the *ad valorem* value for purposes of duty was the price which an importer would give for the article if the article were delivered, freight and insurance paid, in bond at the port of importation [Sec. 12 (2)].[1]

(3) *Matches:* By the Finance (New Duties) Act 1916 (6 GV., ch. 11), Sec. 3 (1), there was imposed as from April 6, 1916, " a duty of Customs at the rate of three shillings and sixpence for every 10,000 matches so imported ". By Sec. 3 (3), " where the Commissioners are satisfied that a box of matches contains more than eighty matches, the Customs (and Excise) duty to be charged on any matches so contained exceeding eighty, shall be at the rate of one shilling and ninepence (and one shilling and eightpence respectively) for every ten thousand matches, instead of three shillings and sixpence (and three shillings and fourpence)."

The Finance Act (1916) (6 & 7 GV., Ch. 24) imposed customs duties on:

[1] Disputes as to valuation were to be referred to a referee for decision (12 (3) (4)). The new duties were subject to drawback on exportation (Sec. 13 (1)); articles mainly used as an accessory or a component part might under conditions to be fixed be imported free of duty (13(3)); motor cars, etc., imported for trade or industrial purposes or for use by local authorities as fire engines or otherwise for the purposes of their fire brigade services; and chassis, component parts and accessories, if properly marked as required by the Customs authorities, might be imported free of duty (13(4)). See also Ham's *Customs Year Book S. V. Tariff.*

(4) *Table waters:* which contain as the result of the ordinary process of manufacture, or are prepared in the ordinary process of manufacture with sugar or other sweetening material, or which are fermented beverages, a duty at the rate of fourpence per gallon, and on any other table waters a duty at the rate of eightpence per gallon. Sec. 9 (1).

(5) *Cider and perry:* A duty of fourpence per gallon on cider and perry (Sec. 8). These duties were imposed as from May 1916.

The table-water duty imposed by this Act and the Excise Duty imposed by the New Duties Act were reduced in the case of "herb beer", so as to be at the rate of twopence per gallon [Sec. 11 (1)]. "Herb Beer" by Sec. 11 (2) means the beverage usually known as herb beer or botanic beer but does not include ginger beer.

(6) *Mechanical lighters:* The same Act by Sec. 10 (1) and (2) imposed a Customs (and Excise) duty on mechanical lighters, viz.: a duty of "one shilling in the case of mechanical lighters requiring the use of spirit, and of sixpence in any other case".

The Finance Act of 1918, Sec. 10, imposed an additional Customs and Excise charge, as from April 23rd, 1918, of one shilling and eight pence for every ten thousand matches.

Apart from the Imperial Preference proposals, the Finance Act, 1919, Sec. 9, lays it down that, "on and after the first day of September 1919 the following excise duties shall be reduced by one-sixth, that is to say, the excise duties payable on tobacco, sugar, molasses, glucose, saccharin and chicory".

(7) *The Entertainments' Duty:* The duties so far discussed are duties on particular commodities whether produced at home or imported from abroad. The entertainments' duty—introduced by the Finance (New Duties) Act of 1916 was technically an Excise Duty, for which reason it is discussed here.

By Sec. 1 of the Act of 1916, a sliding scale of excise duties "for all payments for admission to any entertainment as defined by this Act" was imposed as follows:

	Duty to be
Where the payment, excluding the amount of duty does not exceed 2*d*	a halfpenny
Where the payment exceeds 2*d* and does not exceed 6*d*	one penny
Where the payment exceeds 6*d* and does not exceed 2/6	two pence
Where the payment exceeds 2/6 and does not exceed 5/–	three pence
Where the payment exceeds 5/– and does not exceed 7/6	six pence
Where the payment exceeds 7/6 and does not exceed 12/6	one shilling
Where the payment exceeds 12/6, the duty was to be one shilling for the first 12/6 and 1/– for every 10/– or part of 10/– over 12/6	

By Sec. 1 (5) certain classes of entertainments were excluded (where the entire proceeds were devoted to charitable or philanthropic purposes; where the entertainment was of a wholly educational character; where it was intended only for the amusement of children and not more than one penny per person admission was charged; entertainments for partly educational and partly scientific purposes by non-profit-making bodies. To these exemptions Sec. 12 of the Finance Act 1916 added certain classes of school entertainments, but the rates were left unchanged until the passage of the Finance Act of 1917. By Sec. 3 of this Act, a new scale of duties was imposed:

	Duty to be
Where the payment, excluding the amount of duty does not exceed 2d	a halfpenny
Where the payment exceeds 2*d* and does not exceed 4*d*	one penny
Where the payment exceeds 4*d* and does not exceed 6*d*	two pence
Where the payment exceeds 6*d* and does not exceed 1/–	three pence
Where the payment exceeds 1/– and does not exceed 2/–	four pence
Where the payment exceeds 2/– and does not exceed 3/–	six pence
Where the payment exceeds 3/– and does not exceed 5/–	nine pence
Where the payment exceeds 5/– and does not exceed 7/6	one shilling
Where the payment exceeds 7/6 and does not exceed 10/6	one shilling & 6d
Where the payment exceeds 10/6 and does not exceed 15/–	two shillings
Where the payment exceeds 15/– the duty to be 2/– for the first 15/– and six pence for every 5/– or part of 5/– over 15/–	

The rates were again raised by Sec. 11 of the Finance Act 1918 in so far as the scale under 1/– were concerned, the following being substituted for the amounts above:

Where the payment does not exceed 2½*d*	one halfpenny
Where the payment exceeds 2½*d* and does not exceed 4*d*	one penny
Where the payment exceeds 4*d* and does not exceed 7*d*	two pence
Where the payment exceeds 7*d* and does not exceed 1/–	three pence

This was again altered by the Finance Act of 1919 (Sec. 7) which substituted:

Where the payment exceeds 4*d* and does not exceed 4½*d*	one penny and a halfpenny
Where the payment exceeds 4½*d* and does not exceed 7*d*	two pence

(8) *Motor spirit license duty:* By the Finance Act 1916 [Sec. 15 (1)] there was imposed "on a license to be taken out by any person who desires to be supplied with motor spirit, a duty at the rate of sixpence per gallon of motor spirit, with which he is authorized to be supplied by the license".

It exempted:

1. Users of motor spirit for purposes other than supply of power to motor cars or cycles; or such supply of motive power to motor cars or cycles as is exempted by the Finance Act (1909-10) 1910.

2. To the extent of one-half the duty, any duly qualified medical practitioner or registered veterinary surgeon using a car for professional purposes.

By Sec. 12 (1) of the Finance Act 1919, the excise duty on motor spirit made in the United Kingdom was repealed as from May 1, 1919.

By Sec. 12 (2) of the same Act, the motor spirit license duty ceased to have effect as from May 17, 1919.

IV. THE IMPERIAL PREFERENCE PROVISIONS

The Finance Act of 1919 introduced Imperial Preference in the case of articles subject to Import Duty. The quantitative aspect of the matter is dealt with in the second schedule of the Act, which lays down the following preferential rules:

Goods	*Rate of Duty*
Tea Cocoa Coffee Chicory Currants Dried or preserved fruit within the meaning of S. 8. of the Finance (No. 2) Act, 1915 Sugar Glucose Molasses Saccharin Motor Spirit Tobacco	Five-sixths of the full rate
Articles chargeable with the new import duties imposed by S. 12 of the Finance (No. 2) Act, 1915	Two-thirds of the full rate
Wine;	
Not exceeding 30° of proof spirit	Sixty per cent of the full rate
Exceeding 30° of proof spirit	Sixty-six and two-thirds per cent of the full rate
Sparkling wine in bottles (additional duty)	Seventy per cent of full rate
Still wine in bottles (additional duty)	Fifty per cent of full rate
Spirits	Rates equivalent to the full rates as chargeable under this Act up to Sept. 1, 1919

The preferential rates came into force in the case of tea, on and after June 2nd, 1919, and in the case of any other goods, on and after September 1st, 1919.

Section 8 (1) of the Act lays down the objective conditions necessary for the enjoyment of the preferential rate.

In general it must be shown that the goods " have been consigned from and grown, produced or manufactured in the British Empire ". " The British Empire " means any of His Majesty's dominions outside Great Britain and Ireland and any territories under His Majesty's protection, and includes India, and by order in Council, any future protectorate or mandatory territory may be included within the definition of the British Empire for the purposes of this section, and this Section shall have effect accordingly. But " goods shall not be deemed to have been manufactured in the British Empire as aforesaid unless such proportion of their value as is prescribed by regulations made by the Board of Trade, is the result of labor within the British Empire ", and in the case of goods manufactured within the Empire largely from material " which is not wholly grown or produced in the Empire, the Board (of Trade) may by order direct that the preferential rate be charged only in respect of such proportion of those goods as corresponds to the proportion of dutiable material used in their manufacture which is shown to have been grown or produced in the Empire " [Sec. 8 (2)]. Goods manufactured in bond from preferentially produced material shall to the extent to which they are shown to have been manufactured out of such material, be charged at the preferential rate ".

V. THE INCOME TAX

In the case of income tax, since this is a much more complicated matter than the Customs duties, a more descriptive survey will be required. In many material respects the war period was an important epoch in the history of the tax, not the least important aspect being the codification of the Law in the Income Tax Act of 1918 (8 & 9 G 5, Ch. 40).

(a) *The Extension of the Income Tax to Smaller Incomes and the Reduction of the Abatements*

(1) So far as exempted income was concerned, up to and including the financial year 1914-1915, the limit of exemption was £160. In 1915-1916 and thereafter, the exemption limit was lowered to £130 [Finance (No. 2) Act 1915, Sec. 21 (1)], and this basis was incorporated into the Income Tax Act of 1918. (Part III, Sec. 10, " where the income does not exceed one hundred and thirty pounds, the claimant shall be entitled to exemption from income tax ".)

(2) We next come to abatements. Up to the end of the financial year 1914-15, the abatements ran thus:

When the Income was under	£700	£600	£500	£400
The abatement was	£ 70	£120	£150	£160
By Finance (No. 2) Act, 1915, Sec. 21 (2), the following abatements were allowed when the Income was under	£700 [1]	£600	£500	£400
The abatement was	£ 70 [1]	£100	£100	£120

The same scheme of abatement was continued by Sec. 11 of the Income Tax Act, 1918.

Against this must be set (1) Increase in allowances for children living and under 16 years of age:

At the beginning of 1914 this stood at £10 per child for incomes between £160–£500. It subsequently developed thus:

1914–15 (Finance Act 1914, Sec. 7) Raised to £20 per child for incomes under £500.

1915–16 (Finance (No. 2) Act, 1915) Raised to £25 per child for incomes under £500.

[1] Sec. 21 (2) only deals with abatements on incomes under £600 and therefore by implication left unaltered the abatement on incomes between £600–£700.

1917–18 (Finance Act 1917, Sec. 13) The amounts remained the same but relief was extended to cases where the taxpayer could prove that "he has the custody of and maintains at his own expense a child or children under the age of sixteen years at the commencement of (the financial) year and that neither he nor any other individual is entitled to relief from income tax in respect of the same child or children . . . or if any other individual is entitled to such relief that that other individual has relinquished his claim hereto."

1918–19 (Finance Act, 1914, Sec. 27) (1) Relief in respect of children was extended to incomes below £800 in all cases; (2) In the case of incomes between £800 and £1000, a person who would otherwise be entitled to relief "in respect of three or more children . . . shall be entitled in respect of each of those children above the number of two to relief from income tax equal to the amount of income tax on twenty five pounds."

1919–20 (Finance Act 1919, Sec. 21). Sec. 12 of the Income Tax Act was extended (a) So as to include relief in respect of any child over the age of sixteen at the commencement of the year of assessment who was proved to be receiving full time instruction at any University, college, school or other educational establishment;

and

(b) So as to provide relief in respect of one child from tax upon *forty pounds* and in respect of any child in excess of one, from tax upon *twenty five pounds*.

(3) Allowance for wife, dependents other than children, or expenditure on dependents incurred because of children was first granted by the Finance Act of 1918, Sec. 27 (2) to any person who, having an income under £800, "has a wife

living with him or maintains at his own expense any person being a relative of his or of his wife, who is incapacitated by old age or infirmity from maintaining himself and whose income from all sources does not exceed twenty-five pounds a year . . . shall be entitled in respect of his wife and in respect of every such person as aforesaid whom he so maintains to relief from income tax equal to the amount of income tax on twenty-five pounds."

The provisions of this sub-section which gave relief to an individual in respect of a wife, "shall in the case of any individual being a widower, be extended so as to give relief in respect of a person, being a female relative of his or of his deceased wife, who is resident with him for the purpose of having the charge and care of any child of his."

The same provisions were reenacted, in somewhat different language, as Sec. 13 of the Income Tax Act, 1918.

By the Finnace Act of 1919, Sec. 27 (1), the relief was increased, in the cases comprised in Sec. 13 of the Income Tax Act, from £25 to £50. At the same time similar relief was granted by Sec. 21 (1) (2) "to an unmarried individual who has living with him either his mother (being a widow or living apart from her husband) or some other female relative maintained by him at his own expense, for the purpose of having the charge and care of any brother or sister of his, being a child in respect of whom relief is given under Sec. 12 of the Income Tax Act, 1918, while by Sec. 27 (2) "The relief conferred . . . in respect of the female relative of a widower, or of his deceased wife who resides with him for the purpose of having the charge and care of any child of his, shall be extended so as to confer relief in respect of any such female relative who resides with him in the capacity of housekeeper and not for the purpose of having the charge or care of any child of his."

(b) *The Rise in the "Basic Rate" and the Extension of the Graduation*

As is well known, the British Income Tax law draws a distinction between "earned"[1] and "unearned" income. "The Basic Rate", i. e. the rate enforced at any moment, irrespective of all or any qualifications whatsoever, is the same for both categories of income, but by differentiations of one kind and another, the rate, except for the higher incomes, is never actually the same for the two categories of income. In treating of graduation, etc. we must, therefore, deal separately with earned and unearned incomes.

The basic rate has increased as follows:

In 1913–14 [Finance Act, 1913, Sec. 2 (1)]	The rate was 1/2 in the £
In 1914–15 [Finance Act, 1914, Sec. 2 (1)]. (In consequence of the outbreak of war)	The rate was 1/3 in the £
In 1914–15 (Finance Act, Section 2, provided for a doubling of the rate for the last four months of the current income tax year)	i. e. the rate was 1/8 in the £, a rise of 5d on the whole year
In 1915–16 (Finance Act, 1915, Sec. 10)	The basic rate was raised to 2/6, a rise of 10d.
In 1916 [Finance Act (No. 2), 1915, Sec. 20 (1)]	Provided for an increase of 40% on above rate for the last six months of the year, or the basic rate was raised to 3/—, a rise of 6d.
In 1916–17 [Finance Act, 1916, Sec. 24 (1)]	The basic rate was raised to 5/—, a rise of 2/—

[1] The latest definition of "earned" income is Part III 14 (3) of the Income Tax Act of 1918. Roughly it covers income from labor, pensions, or superannuation allowances, given in respect of the services of the individual or the husband or parent of the individual, etc. income from property attaching or forming part of the emoluments of any individual; any income chargeable under Schedule B (occupation of land) or Schedule D (Annual profits from property, trade, profession, etc.). For full definitions see first schedule to Act.

In 1917–18 [Finance Act, 1917, Sec. 10 (1)]	The basic rate was continued at 5/—
In 1918–19 [Finance Act, 1918, Sec. 17 (1)]	The basic rate was raised to 6/—, a rise of 1/—
In 1919–20 [Finance Act, 1919, Sec. 14 (1)]	The basic rate was continued at 6/—

In addition to these general increases, a special duty of 2 / per £ on the income "derived from securities which are for the time being included in the Treasury special list as defined by this section, while these securities are so included; and the income shall for the purposes of this section be deemed to be derived at the time when the interest or dividends payable in respect of the securities become payable," was imposed by the Finance Act 1916, Sec. 27 (1). The defining clause explains very clearly the purpose of this regulation. The expression "The Treasury special list" meant any list published by the Treasury in the Gazette and for the time being in force, of securities which the Treasury was willing to purchase in connection with any arrangements for the regulation and maintenance of the foreign exchanges.

Until 1914-15, there was no graduation of the tax upon unearned income, that is, all amounts paid at the same rate. The first step was taken in the direction of graduation by Sec. 6 (1) of the Finance Act 1914. Differentiation was effected where the total income did not exceed £2500, by charging earned income at lower rates than unearned income. The fixed allowances were deducted so far as possible from the earned portion of the income. Reference to the schedules of the various finance acts from 1914 on will show a constant difference of 9*d* in the £ throughout in the rate of duty in favor of earned over unearned income.

VI. THE SUPER TAX

The super tax was introduced into British Finance by the celebrated "Lloyd George Budget" of 1909-10. As origi-

naily instituted the super tax applied to incomes of £5000 or more from all sources, and amounted to the taxation of that portion over £3000 at the flat rate of sixpence in the £, so that an income of £5000 paid super tax on £2000; the tax amounting to £50.

Already before the outbreak of war, an important modification was introduced by the graduation of the super tax rates. Unlike the income tax proper, that portion of the total income subject to super tax was differentially treated in its different parts. By the Finance Act of 1914 (4 & 5 G. V., Cap. 10, Sec. 3) the income from all sources liable to super tax was *reduced* from £5000 to £3000 and the following scheme laid down:

First £2500	exempt
Excess over £2500:	
First £500 of the excess	five pence
Next £1000 of the excess	seven pence
Next £1000 " " "	nine pence
Next £1000 " " "	eleven pence
Next £1000 " " "	one shilling and one penny
Next £1000 " " "	one shilling and three pence
"For every pound of the remainder of the excess	one shilling and four pence."

The outbreak of the war led to an immediate change in the rate. The Finance Act of the second session of 1914 (5 G. V., Ch. 7), by Sec. 12, doubled the rates "for the last four months of the current income tax year", so that in effect, the rates for the whole year were increased by 33⅓%.

In the financial year 1915-16 no great change was made at first. The first Finance Act of the year (5 & 6 G. V., Ch. 62) provided by Sec. 10 that "supertax shall be charged at double the rates mentioned in Section 3 of the Finance Act 1914", which was in effect continuing the provisions of the second Finance Act of 1914.

The second Finance Act of 1915 (Finance No. 2) Act 1915 (5 & 6 G. V., Ch. 89) increased the rates on the larger incomes by Section 23, as follows:

That portion of the excess lying above £3000 and under £4000 was taxed at the rate of 2/10 per £.
That portion of the excess lying above £4000 and under £5000 was taxed at the rate of 3/2 in the £.
That portion of the excess lying above £5000 was taxed at the rate of 3/6 per £.

For the two next financial years no change was made—the two finance acts of these sessions continued the rates established by the acts of 1915 (Finance Act 1916, Sec. 24, Finance Act 1917, Sec. 10).

The next finance act, providing for the financial year 1918-19, again modified the position. The Finance Act 1918 (8 & 9 G. V., Cap. 15), by Sec. 20, lowered the income from all sources upon which super tax was payable to £2500, and provided the following scale:

First £2000	exempt
Excess over £2000:	
First £500 of excess	1/-
Next £500 of excess	1/6
Next £1000 " "	2/-
Next £1000 " "	2/6
Next £1000 " "	3/-
Next £2000 " "	3/6
Next £2000 " "	4/-
Every next £ of the remainder of excess	4/6

The position in the financial year 1919-20 was unchanged. The Finance Act of 1919 (9 & 10 George V, Ch. 32), Sec. 14 continued the rates of super tax established by the Finance Act 1918.

Table VIII, which follows, gives super-tax statistics down to 1919-20. The increase in the number of persons

TABLE VIII. SUPER-TAX STATISTICS

The incomes include the amounts *not* subject to Super-Tax as well as the amounts so subject

(Value in £ Million)

Class	1913–14		1914–15		1915–16			1916–17		1917–18		1918–19		1919–20	
£1000	Total Income Assessed	Number of Persons	Total Income Assessed	Number of Persons	Total Income Assessed	Number of Persons		Total Income Assessed	Number of Persons	Total Income Assessed	Number of Persons	Total Income Assessed	Number of Persons	Total Income Assessed	Number of Persons
3–5	..	..	59.77	15,524	55.96	14,613		55.87	14,463	67.26	17,504	93.24	26,629	100.60	28,475
5–10	59.86	8,769	63.99	9,404	62.35	9,148		67.22	9,847	78.44	11,486	84.55	12,369	95.45	13,914
10–15	28.56	2,362	30.78	2,567	28.29	2,327		31.12	2,579	37.22	3,079	40.89	3,379	46.00	3,803
15–20	16.87	980	17.83	1,034	15.70	910		18.63	1,084	21.75	1,265	23.69	1,376	27.76	1,617
20–25	11.21	502	11.93	537	10.67	478		13.54	606	15.91	710	16.14	721	18.94	847
25–35	13.26	452	14.53	495	12.61	434	25–30	8.86	326	11.47	422	12.75	469	13.65	498
35–45	8.83	222	9.09	229	8.10	203	30–40	11.33	330	14.43	420	15.02	435	19.18	556
45–50	6.36	128	3.97	85	3.24	68	40–50	7.35	163	9.49	214	11.72	265	12.97	291
50–55			3.24	61	2.26	43	50–75	9.89	161	14.25	239	14.90	250	15.45	256
55–65	3.81	64	4.50	75	4.05	68									
65–75	3.00	43	3.31	47	2.97	43									
75–100	5.72	65	5.99	69	4.86	56		5.95	69	8.28	98	8.95	102	9.18	107
100–	13.50	75	15.85	90	14.76	82		17.50	95	22.81	127	22.81	112	26.62	140
Totals.	171.00	13,664	244.78	30,211	225.82	28,473		247.30	29,723	301.31	35,564	344.66	46,107	385.80	50,504

From 59th Report of the Commissioners of Inland Revenue and subsequent reports.

from 13,664 in 1913-14 to 50,504 in 1919-20 is of course due primarily to changes in the basis of the tax and not to increase in the number of taxable incomes.

VII. THE DEATH DUTIES

(a) *Death Duties Before the War*

What are spoken of as "death duties" really comprehend a series of duties which fall into two groups, (1) those falling on the estate as a whole; (2) those falling on the portions of the estate passing to any given person. It is this second group which properly constitute an inheritance tax, since the graduation of the duty varies with the difference of kinship. The "estate duty" tax, on the other hand, varies directly with the absolute amount of the estate, independently of to whom the estate passes. Death duties before the war ranged from £1 to £15 per cent, running higher in the estates where death occurred after April 29, 1909 than in the case of the estates where death occurred before. Estates where death occurred before April 29, 1909 were further differentiated in favor of those occurring after August 1st, 1894 and before April 18, 1907.

The Settlement Estate Duty is levied on the principal value of settled property passing on death. (This duty is levied in addition to the Estate Duty.) Small estates, however, not exceeding £300 gross value paid as Estate, etc. Duties, a fixed duty of 30*s*, and if above £300 gross but not exceeding £500 gross, a fixed duty of 50*s*. Property, real and personal (exclusive of property settled otherwise than by the deceased's will) not exceeding £1000 and subject to Estate duty, is exempt from settlement estate duty and also from legacy and succession duties.

These duties before the war ranged from £1 per cent to £10 per cent and varied according as the legatee was husband or wife, child or descendent of a child, brother or sis-

ter; uncle, aunt, etc. Further variation in rates was also based on dates of succession corresponding to those for death duties.

(b) *Death Duties During the War*

(1) *Estate Duty Proper:* These duties were altered by the Finance Act of the First Session of 1914 (4 & 5 G. V., Ch. 10, Sec. 12 and Schedule 1) and were thereafter left at the figures then established until the passage of the Finance Act of 1919, which again altered them (9 & 10 G. V., Ch. 32, Sec. 29 and Schedule III). The increase raised the maximum in 1914 to £20 per cent and in 1919 to £40 per cent, the increases being principally on the larger estates. In addition to changes in the rate, the Estate duty was also modified in other respects: (a) by Sec. 13 (1) of the Finance Act 1914, the total duty payable on an estate . . . "shall, when necessary, be reduced so as not to exceed the highest amount of duty which would be payable at the next lower rate, with the addition of the amount by which the value of the estate exceeds the value on which the highest amount of duty would be so payable at the lower rate". (b) By Sec. 30 of the Finance Act 1919, the rate of interest was raised from three to four per cent: "Section 18 of the Finance Act 1896 (which determines the rate of interest on death duties), shall in its application to interest accruing after the commencement of this Act, have effect as though four per cent were substituted for three per cent, as the rate of interest per annum."

(2) *Succession and Legacy Duties and Settled Estate Duty:* (a) The Finance Act, 1914, Sec. 13 (2) limits the amount of succession and legacy duty payable in certain cases in somewhat the same way as the total estate duty payable when the net value of the property exceeds one thousand pounds "the amount of legacy and succession

duty payable in respect of the property shall not exceed the amount by which the net value of the property as estimated for the purposes of estate duty exceeds one thousand pounds"; (b) Sec. 14 provides (1) for the cessation of relief from estate duty given by certain sections of the Finance Act of 1894, in the case of persons dying after August 15, 1914, and further provides that "settlement estate duty shall not be levied in the case of persons dying after the eleventh day of May", certain provisions and safeguards being contained.

(3) *Relief in respect of Quick Succession:*[1] By Sec. 15 of the Finance Act of 1914, where any property "consisting of land or a business (not being a business carried on by a company) or any interest in land and such a business" passes by death for a second time within five years after the estate duty has become payable in consequence of a death, the amount of estate duty payable on the second death is reduced in the following proportions:

50% if the second death occurs within 1 year of the first.
40% if the second death occurs within 2 years of the first.
30% if the second death occurs within 3 years of the first.
20% if the second death occurs within 4 years of the first.
10% if the second death occurs within 5 years of the first.

But if the value of the property has increased "the latter value shall be substituted for the former for the purpose of calculating the amount of duty on which the reduction under this section is to be calculated."

[1] The relief comprehended under this Section must, of course, be distinguished from relief granted specifically to hardships caused by deaths on military service, for which see Death Duties (Killed in War) Act 1914 (4 & 5 GV Ch. 76) which was extended by Sec. 46 of the Finance Acts (No. 2) 1915 retrospectively to succession and legacy duty.

VIII. THE EXCESS PROFITS DUTY

(a) *Aim and Purpose of the Duty*

The Excess Profits Duty was originally instituted as part of the policy associated with the speeding-up of output in munitions industries in the early days of the European war. As a compensation to the principal trade unions in surrendering for the period of the war any restrictive practices limiting output, the government agreed, *inter alia,* to restrict the profits of manufacturers in munition industries.

The first legislation in connection with the limitation of profit is therefore to be found in the Act known as the Munitions of War Act, 1915 (5 & 6 G. V., Ch. 54). The object of the Act was, *inter alia,* to create a special class of establishment to be known as a "Controlled Establishment" created by an order of the Minister of Munitions. In such an establishment certain limitations were imposed both upon proprietors and workers, including more particularly a limitation of the divisible profits of the undertaking (Part II, Sec. 4). By Sec. 5 (1), ". . . . . the amount of profits divisible under this Act shall be taken to be an amount exceeding by one-fifth the standard amount of profits."

The standard amount of profits for any period was taken to be the average of the amount of the net profits for the two financial years of the establishment completed next before the outbreak of the war or a proportionate part thereof. By Sec. 5[1] (3), "if in any case it appears or is represented to the Minister of Munitions that the net profits or losses of all or any other establishments belonging to the same owner should be brought into account, or that the average under this section affords or may afford an unfair standard of comparison, or that no such average exists or affords no

[1] As amended by Sec. 19 of the Munitions of War (Amendment Act) 1916.

standard comparison, the Minister may, if he thinks just, allow or require those net profits or losses to be brought into account, or substitute for the average such an amount of the standard amount of profits as may be agreed upon with the owner of the establishment."

These matters might, and if demanded by the owner, had to be referred to a board of referees or a single referee appointed by the Minister, "and the decision of the referee or board shall be conclusive on the matter for all purposes."

At the same time the Excess Profits Duty was being widely extended by Part III of the Finance (No. 2) Act, 1915. For some time the two Acts were applied side by side, one administered by the Revenue Department, the other by the Ministry of Munitions. But Sec. 48 (1) of the Finance Act 1916 provided for adjustment of payments, so far as controlled establishments were concerned, of excess profits duty and the "Munitions Exchequer payments", and by Sec. 24 (1) of the Finance Act 1917, the provisions of Sec. 4 of the Munitions Act 1915 "shall not apply to any profits arising after the 31st day of December, 1916 or apportioned under this Act to the period after that date", while by Sec. 24 (2) "Munitions Exchequer payments arising *on or before* the 31st day of December 1916 or apportioned under this Act to the period down to and including that date shall, after the passing of this Act, be assessed and collected, or, if already assessed but not collected, collected by the Commissioners of Inland Revenue." As from January 1917, the whole of the collection of Excess Profits Duty and the basis upon which it was imposed, were uniform both "for controlled establishments" and other establishments, except in so far as special conditions were not laid down by the Finance Acts themselves.

(b) *The Rate and the "Accounting Period"*

What makes the exposition of the changes in the rate so difficult is the basis of time upon which it was built. This basis was the accounting period, which by Sec. 38 (2) of the Finance Act 1915 " shall be taken to be the period for which the accounts of the trade or business have been made up, and where the accounts of any trade or business have not been made up for any definite period, or for the period for which they have been usually made up, or a year or more has elapsed without accounts being made up, shall be taken to be such period not being less than six months or more than a year ending on such a date as the Commissioners of Inland Revenue may determine". It follows that an "accounting period" may cut across the time limits set up by the Act, after which a rise shall be operative and creates the problem of apportionment of rates.

The rates fixed were as follows:

By Finance (No. 2) Act 1915, on Accounting periods ending between August 4, 1914 and July 1, 1915 ..... 50%

By Finance Act, 1916, Sec. 45 (1) (2) applies to accounting periods between July 1, 1915 and August 1, 1917 .. 60%

> As respects excess profits arising in any accounting period beginning after the expiration of a year from the commencement of the first accounting period," the amount due to be proportionally based on 50% and 60% in cases " where part of an accounting period is after and part before the date of the expiration of a year from the commencement of the first accounting period."
>
> In the case of trades or businesses commencing after August 4, 1914, the rate of 60% was to be levied in respect of any accounting period ending after August 4, 1915.

Finance Act 1917 (Sec. 20 (1) (2) applies to accounting periods ending between August 1, 1917 and August 1, 1918 .... 80%

> "As respects excess profits arising in any accounting period *commencing* on and after January 1, . . . or, in the case of an accounting period which commenced before that date, but ends after that date, as if 80% were substituted for 60% as respects so much of the excess as may be apportioned under this Act to the part commencing on that date."

By Finance Act, 1918, on Accounting periods ending between August 1, 1918 and August 1, 1919 (Sec. 34) as in previous periods . . . i. e. 80%

By Finance Act 1919. Applies to accounting periods between August 1, 1919 and August 1, 1920 .... 40%
Sec. 32 (1) and (2)

> (1) "as respects excess profits arising in any accounting period commencing on and after January ary 1, 1919 . . . or in the case of an accounting period which commenced before that date but ends after that date, as if 40% were substituted for 80% as respects so much of the excess as may be apportioned under this part of this Act to the part commencing on that date."

(c) *Calculation of the Excess*

The taxable excess was fixed by Finance Act 1915, Sec. 38 (1) as "the amount by which the profits arising from any trade or business . . . in any accounting period . . .exceeded by more than two hundred pounds the pre-war standard of profits"

or, if X be the prewar profits

Y the profits in any accounting period

$\frac{N}{100}$ the rate of tax

$$\text{The tax is equal to } \frac{N}{100}\,[Y - (X + 200)]$$

(d) *The Ascertainment of the Pre-War Standard of Profits*

Two methods were laid down by the Finance Act 1915, Sec. 40 (2):

(1) *Profits standard:* i. e. "the amount of profits arising from the trade or business on the average of any two of the three last pre-war trade years to be selected by the taxpayer", but by Schedule 4, Part II, 3, "where it is shown to the satisfaction of the Commissioners of Inland Revenue that the three last pre-war trade years have been years of abnormal depression, any *four* of the last *six* pre-war trade years may be substituted for the purpose of the pre-war standard of profits for any two of the three last pre-war trade years. The last three pre-war trade years shall not be considered as years of abnormal depression unless the average profits of three years have been at least twenty-five per cent lower than the average profits of the preceding three years." [1]

(2) *Percentage Standard:* "an amount equal to the statutory percentage on the capital of the trade or business as existing at the end of the last pre-war trade year, subject, however, to the provisions of this Act as to any alterations in

[1] By Schedule 4, Part II, Sec. 4 where there have not been three prewar years but two prewar years, the profits standard was to be either the average of the two (or at option of tax payer) the profits of the last prewar year; where there was only one prewar year, the profits of that year; if no prewar year, the statutory percentage was to apply.

the manner of calculating the percentage standard in special cases. The statutory percentage shall be six per cent in the case of a trade or business carried on or owned by a company or other body corporate, and seven per cent [raised to 8% by Finance Act 1917, Sec. 26 (2)] in the case of any other trade or business, subject, however, to the provisions of this Act to the increase in that percentage in certain cases ".

The application of either standard was governed by the principle [Sec. 40 (2)] " that when it is shown to the satisfaction of the Commissioners of Inland Revenue that that amount (i. e. profits standard) was less than the percentage standard . . . the pre-war standard of profits shall be taken to be the percentage standard."

This displays the general principles, but these were subject to considerable modification in detail, of which only the more important will here be referred to.

(3) *Increases of Statutory Percentage, etc.:* By Sec. 24 of the Finance Act 1915, application might be made to the Treasury for reference to a Board of Referees for:

Increases in the statutory percentage " as respects any class of trade or business " or for a calculation of the percentage standard in those cases " in which the amount of capital actually employed in the trade or business is . . . small compared with the capital necessarily at stake for that trade or business, by reference to some factor other than the capital of the trade or business or to some additional factor."

Alteration of pre-war profits standard " as respects capital employed for the purpose of the manufacture of war materials or for munitions work and which could not be expected to be remunerative or wholly remunerative except in time of war, in a business which has been wholly or mainly carried on for those purposes."

In this way the percentage standard had in some cases been greatly increased, e. g.

22½% for gold mining (Rhodesia).
11% for Antimony mining and smelting (Mexico).
15% for aircraft manufacturing & Westend Theatres.
11% for Cinematographs.
9% for coal mining and so on.

By Sec. 40 (3) of the Finance Act 1915 the Commissioners of Inland Revenue were to have power to modify the provisions of Schedule 4 to the Act (relating to computation of Profits, etc.) on the application of a taxpayer. "Owing to a change in the constitution of a partnership, or to the postponement or suppression, as a consequence of the present war, or renewals or repairs or to exceptional depreciation, or obsolescence of assets employed in the trade or business due to the war, or to the necessity in connection with the present war of providing plant which will not be wanted for the purposes of the trade or business after the termination of the war, or to any other special circumstances specified in regulations made by the Ministry." [1]

(4) *Increase of Exempted Amounts:* Sec. 26 (4) of the Finance Act 1917 introduced the following modifications:

(1) where the profits were less than £2000 and the prewar profits less than £500, the exempted amount was increased by 1/5 of the difference between the actual profits and £2000; i. e. where

[1] By Sec. 25 of the Finance Act 1917 the powers of the Board of Referees were widened by its being given power to deal with matters already decided by the Board, i. e. "if they think fit, on cause being shown by additional evidence or otherwise (to) reopen the case and make any order which they could have made on an application relating to matters not already decided by them, and may revise any order previously made by them affecting that class of trade or business."

E was the exemption amount,
Y was the actual profit,
X was the prewar standard.

$E = 1/5\ (2000 - Y) + 200$

(2) If the prewar profits were over £500 and the actual profits were under £2000, the same exemption was given, reduced by the amount by which the prewar standard was above £500, i. e.

$E = 1/5\ (2000 - Y) - (X - 500) + 200$

(3) Under the original Act Sec. 41 (1) new capital was provided for by deducting from the profits of the accounting period an amount equal to the statutory percentage on that new capital for the period of time actually concerned by its employment, or adding an amount calculated in the same way for decrease of capital.

By Sec. 26 (1) of the Finance Act 1917, the statutory percentage was increased by 3% in all cases whether for additions or deductions in so far as accounting periods ending *after* Dec. 31, 1916 were concerned.

(e) *Scope of the Act*

The trades and business to which the Excess Profits duty applies were defined by Sec. 39 of the Finance (No. 2) Act 1915, as "all trades or business (whether continuously carried on or not) of any description carried on in the United Kingdom, or owned or carried on in any other place by persons ordinarily resident in the United Kingdom, excepting:

(a) husbandry in the United Kingdom,
(b) offices or employments,
(c) any profession the profits of which are dependent mainly on the personal qualifications of the person by whom the profession is carried on and in which no capital expenditue is required, or only capital expenditure of a comparatively small amount,

but including the business of any person taking commissions in respect of any transactions or services rendered, and of any agent of any description (not being a commercial traveller, or an agent whose remuneration consists wholly of a fixed and definite sum not depending on the amount of business done or any other contingency)."

(f) *Discussion of Excess Profits Tax*

The Excess Profits Tax as a war measure is theoretically sound. Assuming that profit-making is a necessary incentive to maximize production, a device which would give that incentive but which would limit it to one-fifth of the war period surplus over normal, has much to commend it. But was any excess over normal profits necessary? Did the industries making war necessities require this 20 per cent bribe over what was, from the standpoint of equity, a fair return for their service to the country in a national crisis? It has been pointed out elsewhere that men like Hartley Withers believed that 75 per cent taxation might have been successfully imposed, because the country was ready for extreme sacrifices to prevent German invasion. Did those who stayed at home to produce the instruments of war really need coddling to perform their vital service to the country, while other Britishers in large numbers were sacrificing their lives at the front? An invasion by Germany would have meant great losses by these same industries, either directly or through reparations. It has also been pointed out that in contributing to the Great War Loan of 1917, the public responded to patriotic appeal and subscribed heavily with little reference to the interest rates. It is generally conceded that a lower rate would have had little effect on the response to the Government's plea for financial support. Sacrifices in food consumption, heating, clothing, and amusements were generously made by the people, and yet a bonus to industries was deemed necessary!

A 100 per cent excess profits tax would seem to have been practicable as well as just. The difficulties of administration would have been no greater than for the 80 per cent tax. On the other hand, with the 100 per cent levy there would have been no incentive to pass all, or any part of it, on to the consumer (for the most part the Government), and one of the fruitful sources of price inflation would not have existed. It is generally conceded that under the conditions of scarcity which a war induces, such taxes will be passed on and prices will rise. When buyers dominate a market competition renders this impossible, but a war such as the Great War brings about a seller's market, with price subordinate to supply. Price increases which result become cumulative, and affect the whole price structure, including wages.

Better, perhaps, than any excess profits tax, even a 100 per cent tax, are stringent price fixing; wage, salary and capital controls; and the furnishing of funds to war industries by the government. Every major participant in the great struggle, including the United States, had reached such comprehensive controls by the time the armistice was signed. Had these measures been invoked in Great Britain after the first months of the war, inflation would have been minimized, war costs greatly reduced, and the excess profits tax rendered necessary only as another means of control. The excess profits tax might properly have been called the "excess price" tax, for the government simply took back, through this duty, *part* of what it paid manufacturers in the form of excess prices for war goods.

IX. BRITISH TAXATION POLICY

Except for the general criticism of inadequacy of taxation, and the suggestion that the excess profits duty should have been on a 100 per cent instead of an 80 per cent basis, little can be said in condemnation of British taxation policy during

the war. It was sound in theory and most efficiently directed. The aim of war taxation is to transfer on a large scale purchasing power, which represents claims on the stream of current production, from private to government hands. This can be done by expropriation (taxation) or by borrowing. In either case it is for the most part control or disposition over current production which is taken. Through foreign loans a government obtains control over goods being produced abroad. Its solvency can be maintained as long as its consumption does not exceed its home production plus obtainable production from abroad.

Great Britain did not succeed in stimulating production to the full amount of its war-period consumption. It secured supplies essential to make up the lack in its own output through gold shipments, security sales abroad, and foreign borrowings. The gold was, for the most part, new production within the British Empire, the securities were part of past accumulations abroad, and the borrowings were about offset by lendings to the Dominions and the Allies. Hence taxation and domestic borrowings did not fall far short of taking care of war production requirements.

What has been said in general approval of British taxation policy during the war is not intended to indicate that an absolutely equitable imposition of tax burdens was achieved. This is difficult enough under relatively stable peace conditions, and is practically impossible under the stress of rapidly changing incomes during a war period. The income tax is generally regarded as the best instrument with which to apply the principle of "ability to pay," yet this tax, despite allowances and abatements, worked a great hardship on people with fixed incomes from salary or investments. Increased taxation is possible on the assumption of increased production, or of decreased consumption without impairment to production. War mobilization was intended to

bring about both. As a matter of fact, increased production was reflected in the incomes of many, but not in the case of those with relatively fixed incomes. As has been shown, the Excess Profits duty, during the period of its highest rate, provided a 20% bonus for those engaged in war industries, and these individuals and firms, together with the large income-tax payers, could partly compensate themselves in advanced prices. The circumstances of the war themselves for the most part provided the contribution of these classes to the war cost, giving them in addition funds to buy government bonds and thus secure claims on future national revenue. Those with fixed incomes, however, despite effort to provide for their special status in the various budgets, carried heavy burdens of taxation.

Wage earners readily received advances and thus tended to pass on such taxes as they paid on income. Various direct taxes, such as certain types of excise, entertainment, etc., which were excellent in themselves, had little effect on the people of large income because of their aggregate per capita insignificance. In the case of the wage earner, furthermore, compensation for these taxes was secured in a general way. Workers everywhere during the war quickly acquired the habit of bargaining in terms of real rather than money wages. Those with fixed incomes, however, had as little recourse from the burdens of the various direct taxes as they had from the income tax, and so suffered very great hardships from these also.

The matter of the respective merits of direct and indirect taxation has been a subject of discussion since the beginning of the science of public finance. It is generally recognized by competent authorities, however, that each has its proper place in the present complex organization of industry and trade. Many indirect taxes, in their incidence, add to the price of the commodities affected an amount in excess of the

government's receipts, but because of their indirectness meet with less resistance in their imposition and less evasion in their collection. Income and inheritance taxes, which are today the principal direct taxes, require a system of government records and accounts not easily built up. However, once the machinery has been organized and properly adjusted to the principle of "ability to pay" these are the most sound and equitable forms of tax. Though the war did much to stimulate their development in Europe and America, resistance to these direct taxes is still strong and evasion widespread. Indirect taxes will therefore be availed of for a long time to come, especially in view of the heavy taxation requirements of this present after-war period.

Just before the war, Great Britain's receipts from direct and indirect taxation were almost evenly divided. While the war caused a tremendous increase in all forms of duties, direct taxation increased in greater proportion than indirect. This was particularly true in the later years of the war, when the Excess Profits levy made such a large contribution. Reference to the Table III on page 79 will show that for the fiscal years 1914 to 1920 Income Tax, Excess Profits Tax and Death Duties together yielded 58.5% of revenue. Since there were also direct taxes under the heading of Excise and Other Revenue, the aggregate percentage of direct taxes was considerably higher than this figure.

There is little purpose in discussing the respective theoretical merits of the various types of taxation availed of during the war. In the emergency the problem was not one of deciding between the alternatives of direct and indirect taxation, or of choosing one among different forms of either. It was a matter of determining where and how maximum revenue could be secured without undue economic disturbance. Every possible source had to be tapped. Income and profits offered the greatest opportunity for exploitation,

but consumption could not be overlooked as a source from which to derive revenue. Excise taxes, especially on liquors and tobacco, entertainment and transportation levies, stamp duties, etc., not only served the purpose of yielding a return that otherwise would not have been secured, but since they were luxury or semi-luxury taxes they tended to bring about the restriction of consumption so necessary in a war period. Had a greater volume of war taxation been decreed, as was most desirable, this could equitably and without harm have been secured by increased super-taxes and by a 100% Excess Profits tax. In other words, greater revenue should and could have been obtained from those who were able to pay more and demonstrated this ability by their large subscriptions to war loans. Especially in contrast to taxation policy in other belligerent countries, however, and in view of the problems to be solved, British war taxation as a whole has been regarded by experts as remarkably successful under the circumstances.

With patriotic incentive gone and government war powers relaxed, the post-war taxation problems presented renewed difficulties. The country had to be put on the basis of paying its way as soon as possible. Quick conversion of the national economic machine from war-time to peace-time functioning had to be brought about. Sound, enlightened taxation policy was vital to the successful accomplishment of this purpose. That Great Britain's taxation principles were sound and courageous is attested by the rapid financial recovery of the country in the years immediately following the war. Some further discussion of post-war taxation will be taken up in the last chapter.

CHAPTER III

Government Borrowings

In the preceding consideration of revenue derived from taxation, it was pointed out that for the period from August 1, 1914, to September 30, 1919, only 30.5% of the government's income was secured from that source. The large remaining proportion, 69.5%, was secured from government borrowings, to which this chapter is devoted. The government used many different methods of obtaining money on loan, just as it tapped every legitimate source of taxation. The raising of funds on the scale required made necessary the exercise of considerable ingenuity in providing methods of lending to the government which would appeal to every class of citizens. Before the war was over, borrowing had been organized into a comprehensive system which worked as smoothly and as effectively as taxation collection. The machinery was set up to yield, and did yield, on the whole, what the treasury had estimated was necessary in the light of probable expenditure and calculated return from taxation.

The present chapter summarizes the total war cost and the national debt, which is a direct reflection of the extent to which war borrowings were used to produce income. It has been pointed out elsewhere that greater use of taxation not only would have resulted directly in a smaller post-war debt, but also, through its check on inflation, would have reduced the war cost and post-war debt burdens. The various forms of borrowings are also discussed, together

with the final working out of the system of continuous borrowing. This latter system had many advantages over the method of periodic loan drives, which caused a great deal of disturbance in the financial machinery of the country, and were a fruitful source of credit inflation on that account. All government borrowing, particularly that which was carried by the banks, induced inflation, but the loan drives did this to an especially great degree because of the credit strain which they brought about and the pressure they exercised to accelerate credit creation.

A peculiar and troublesome phase of the government's war borrowings was the large dimensions reached by the floating debt. The problem of funding that debt, which resulted from the issuance of Treasury bills and from Ways and Means Advances, gave the Treasury serious concern in the immediate post-war period. In considering the various types of government borrowings effort should be made to distinguish between those which represented, approximately at least, capital savings, and those which were based largely on manufactured credit. This is difficult, because even the war loans were to a considerable extent bought by the banks with artificially created credit or carried by the banks for their clients with this same kind of credit. However, the short-term loans, especially Ways and Means Advances, were definitely pure credit creation, and to call them loans is to give a somewhat erroneous idea of their nature. Even Treasury bills, which presumably took funds from the money-market supply, were because of their great volume largely bought with money created by the machinery of the Currency Note Account and Ways and Means Advances. The currency notes were an integral part of the mechanism on which the government's short-term borrowing was based. There is an interesting analogy between the British currency note issue and the issue of greenbacks in the United States

during the Civil War. The comparison of these two issues made at the end of this chapter will be of assistance to American readers in understanding the true character of the currency notes.

I. SUMMARY OF GOVERNMENT BORROWINGS

Great Britain's total governmental expenditures from August 1, 1914, to September 30, 1919, were £10,271,497,360. As her expenditures for the year before the outbreak of the European war were about £198,000,000, her normal expenditures during the period may be estimated to have been in the neighborhood of £1,000,000,000, and her total expenditure incurred directly on account of the war up to September 30 may be set down as about £9,000,000,000. These figures include loans to her Dominions and Allies, stated by the Chancellor of the Exchequer in his revised budget statement of October 23, 1919 to be £1,961,000,000 (£1,740,000,000 to the Allies and £221,000,000 to the Dominions). Mr. Bonar Law, as Chancellor of the Exchequer, estimated that only one-half of the loans to the Allies can be considered as recoverable, £568,000,000 of the amount having been lent to Russia alone. There must also be deducted recoverable assets consisting of surplus stores, stocks of commodities, etc., and arrears of excess profits duty estimated by the Chancellor of the Exchequer in his statement of October 23rd, 1919 as £425,000,000 and £240,000,000 respectively. Deducting one-half of the loans to the Allies and the £665,000,000 that was recoverable against outstanding assets, the net cost of the war to Great Britain up to September 30, 1919 may be roughly set at £7,500,000,000.

In discussing the percentage derived from taxation at the beginning of the chapter, figures for total expenditure, not *net* cost of the war are used. Total expenditure was £10,271,497,360 and taxation was £3,137,207,348 or 69.5% and 30.5% respectively.

COST OF WAR TO SEPTEMBER 30, 1919

Total governmental expenditures, August 1, 1914 to September 30, 1919		£10,271,497,360
Estimated normal expenditures, 5 years, August 1, 1914 to September 30, 1919	£1,000,000,000	
Loans to Allies (£1,740,000,000) of which one-half is estimated recoverable	870,000,000	
Obligations of Dominions	200,000,000	
Outstanding obligations of India in respect of British War Loan	21,000,000	
War assets, surplus stores, etc	425,000,000	
Arrears of excess profits duty	240,000,000	
		2,756,000,000
Net cost of war to September 30, 1919		£7,515,497,360

Figures for the national debt are equally vast. In August, 1914, the debt was £653,300,000, and on September 30, 1919, £7,778,200,000, an increase of £7,124,900,000.[1] It is notable that the estimate of *net* cost of the war to September 30, 1919 and the increase in the national debt on that date come to almost the same amount. Taxation covered somewhat more than the aggregate of items deducted from total government expenditure in the table above.

The revised budget statement for 1919-20 showed a deficit of £473,645,000 and an estimate for the national debt on March 31, 1920, when it was expected that all necessity for further borrowing would be at an end, of £8,075,000,000. From this should be deducted the loans to the Dominions, one-half of the loans to the Allies and the Recoverable Assets, leaving a debt of £6,319,000,000, the burden of which will have to be borne by the British taxpayer. Receipts from Germany under the Peace Treaty will somewhat reduce the net debt but the amount is indeterminate because of the uncertainty of Reparation Payments. Against the great expenditures mentioned above, there was raised by revenue

[1] Figures taken from the *London Economist* of October 4, 1919.

up to September 30th, 1919, the sum of £3,137,207,348, which even with the amount raised by loans, left a deficit of £580,154, this amount being accounted for by a decrease in Treasury balances over balances of August 1, 1914.[1] The measures by which this greatly increased revenue was obtained, have been discussed; the methods used to borrow money, therefore, will now be briefly described.

Great Britain floated three "War Loans", the first in November 1914; the second in July 1915; the third in January 1917. The government thereafter abandoned the policy of fixed subscription periods for loans, and in October 1917 placed on continuous sale its issue of "National War Bonds". The issue was not withdrawn until January 1919 and then only to make way for a new issue which made its appearance on February 1. All of these securities, as their name implies, were more or less long-dated paper, the maturity dates running from 1923 to 1947. As against the periodic "drive" method these bonds were successfully sold by continuous advertising and well-organized propaganda and appeal.

Besides these loans the Government borrowed on Treasury bills running from three to twelve months; on war savings certificates, corresponding to the security of the same name in the United States and—before the appearance of the national war bonds — on Exchequer Bonds, having maturity dates from October 1919 to 1930 and bearing interest from 3% to 6%. There was also a small issue of so-called war expenditures certificates, issued in 1916-17, but paid off within the next two years. A joint loan with France, and a loan in which Great Britain figured alone, were floated in the United States before our entrance into the war, and loans were also obtained in Japan and in the Argentine Republic. Commencing in April 1917, the United States

[1] Figures taken from the London *Economist* of October 4, 1919, p. 105.

Treasury advanced large sums directly to the British Government. Temporary advances, also known as Ways and Means Advances, were obtained as occasion required from the Bank of England. The amount of such advances was frequently very large, having been on April 26th, 1919, £472,000,000.

The means by which the money raised on loan was obtained, and the growth of the national debt, are shown as accurately as may be in the following table, taken from the *Economist* of October 4th, 1919.

(Figures in £ Million)

	Aug. 1, 1914.	Mar. 31, 1915.	Mar. 31, 1917.	Mar. 31, 1918.	Mar. 31, 1919.	Sept. 30, 1919.	Change since Aug. 1, 1914.
Funded debt	586.7	583.3	317.8	317.7	317.7	317.7	— 269.0
Term Annuties	29.6	28.0	24.0	21.9	21.0	21.9	— 7.7
Unfunded debt:							
3½% war stock	......	349.1	62.7	62.7	62.7	62.7	+ 62.7
4½% war stock	......	......	20.0	16.1	16.1	16.1	+ 16.1
4 & 5% war stock.	......	......	1,962.4	2,090.5	1,993.8	1,958.2	+ 1,958.2
Nat. War bonds	......	......	......	625.8	1,692.2	1,744.1	+ 1,744.1
4% Funding Loan	......	......	......	......	......	212.1	+ 212.1
4% Victory Bonds	......	......	......	......	......	201.1	+ 201.1
Treasury bills	15.5	78.2	463.7	973.4	957.0	851.9	+ 836.4
Excheq. bonds	20.5	67.4	320.3	391.7	392.6	392.6	+ 372.1
War Sav. crts.	......	......	74.5	137.7	227.3	259.3	+ 259.3
War Expend Do	......	......	23.6	22.9			
*Other debt	......	......	316.5	936.9	1,255.2	1,293.5	+ 1,293.5
American loan	......	......	51.4	51.4	51.4	51.4	+ 51.4
Temp. Advances	1.0	......	217.5	192.3	456.5	395.6	+ 394.6
	653.3	1,105.0	3,854.4	5,841.4	7,444.4	7,778.2	+ 7,124.9
Other Cap. Liabilities	57.2	57.0	52.2	49.2	49.2	48.9	— 8.3
Total Liabilities	710.5	1,162.0	3,906.6	5,890.2	7,492.6	7,827.1	+ 7,116.6

* Includes advances from U. S. Treasury, Japanese Loan, Argentine Loan, etc. "American Loan" means joint Anglo-French Loan of 1915.

II. CHRONOLOGY OF WARTIME BORROWING

(a) *Treasury Bills*

As long as it adhered to the policy of fixed period loans, the government very largely relied on Treasury bills to bridge the gap between issues, expecting when the bills reached too large a sum to reduce the amount by the proceeds of Exchequer bonds or another loan. Seventy-seven million, two hundred thousand in Treasury bills were outstanding on March 31st, 1915. Subsequently they were issued continuously and without limit, with the exception of a short interval between January and March, 1917, when the Bank of England accepted Treasury bills under discount at 5% in payment of fully-paid allotments of War Loan 5%, 1929-1947 and War Loan 4%, 1929 to 1942. They were issued in denominations of £1000, £5000 and £10,000, and at times exceeded one thousand million pounds, having hardly decreased at all after the policy of continuous borrowing on bonds was commenced. On September 30th, 1919, there were £851,900,000 outstanding. At first only three, six and nine months' bills were offered; later, twelve months' bills were added, but issues were as a rule confined to three and six months' bills. At first they were sold in definite amounts and offered in the market to the highest bidder, but they later were available in unlimited quantities upon application, and bore interest of 4% and 5%. This rate was fixed by the Treasury on October 6th, 1919 after successive changes, as follows: February 14, 1918—3½%; January 14, 1919—4%; October 6th, 1919 (3 months), 4½%—(6 months) 5%.

(b) *The First War Loan*

The first war loan was offered in November, 1914. It was issued at 95, bore 3½% interest and was repayable at par on March 1, 1928, or with three months' notice at any

time between March 1, 1925 and the latter date. The yield, making allowance for the discount at which it was issued, amounted to 3.70%. Subscribers were required to deposit £2 on each £100 taken, and to make payments of £3 December 7th, and of £10 December 21st, and similar amounts each two weeks until the total payment was concluded April 26, 1915. They were issued in £100, £200, £500 and £1000 denominations, and about £350,000,000 was taken.

Mr. Lloyd George, then Chancellor of the Exchequer, in announcing the issue, said it was the general opinion that under the conditions then existing it would be hopeless to try to float a loan bearing a less return. A simple 4% bond, issued at par, was open to the objection that in the event of a long war the investor would have no guarantee against depreciation The prospect, however, of repayment at par and at an early date would prevent depreciation of the proposed issue, which, on the contrary, would be certain to appreciate as the date of maturity approached, regardless of the duration of the war. This, said the Chancellor, was infinitely better from the investor's point of view, as an appreciating security lent itself more readily to purposes of credit, a consideration that would be increasingly important as the war went on. As a matter of fact, the loan had depreciated considerably before the issue of the second loan, in July of the following year.

(c) *War Expenditure Certificates*

War Expenditure Certificates were first issued in June, 1916, at a fixed rate of discount, subject to variation, and payable two years from date of issue. The Certificate could be obtained in amounts of £100, £500, £1000, £5000 and £10,000. The issue ceased in January 1917, and the certificates were accepted under discount at 5½% in payment of fully-paid allotments of 5% War Loan, 1929-1947, and 4%

War Loan, 1929-1942. No further issue of War Expenditure Certificates was made after January 1917, and the certificates were paid off in 1918.

(d) *Exchequer Bonds*

Three- and five-year Exchequer Bonds were, as has been said, used to fill up the gap between the war loans and to reduce the amount of treasury bills when the volume grew too large for the discount market. Originally only five-year bonds were issued, but at the beginning of 1916 three- and five-year 5% bonds were offered, the government having the option of paying the latter at the end of either period. The large amount of Treasury bills at one time, in October 1916, forced the Government to pay the exceptionally high rate of 6% on Exchequer bonds, but this issue had been withdrawn by the end of the year. At other times the rate never exceeded 5% and there were several issues in 1917 bearing only 3%. In December 1917 all issues of Exchequer Bonds were withdrawn, the intention being to concentrate public interest on the continuous National War Loan commenced two months before. Up to April, 1915, there had been issued £50,000,000 of Exchequer Bonds, maturing in 1920. Borrowing in the form of Exchequer Bonds from August 1, 1914 to August 23, 1919, amounted to £638,633,000.

(e) *The Second War Loan*

At the time the second war loan was offered in July 1915, 235 millions of Treasury bills had been sold, of which sixteen and one-half millions had been used to pay off some of the Boer War Debt. It carried extensive provisions for the conversion of older governmental securities, and for that reason no definite amount was set as a limit. It was issued at par, bore 4½% interest, was redeemable in 1945, with the government's option of repayment in 1925 or after.

Mr. McKenna, the Chancellor, in announcing the issue, said that as the first loan, at its depreciated value, bore 4½%, there was no possibility of issuing the present loan at less than 4½%. More than 900 millions were issued, of which a little less than two-thirds were new subscriptions, the remainder being conversion of other securities. Fully 200 millions of the amount was taken by the joint-stock banks.

For the purpose of conversion into the new loan consols were rated at 66⅔; and the annuities were exchangeable into the loan at £78 for the 2½ per cents, or £67 for the 2¾ per cents to £80 of the loan. Conversion of the first loan was arranged on the basis of £100 of first loan and a cash payment of £5 thereon for £100 of the latter. The smallest denomination sold through the Bank of England was £100 but bonds of £5 and £25 were sold through the postoffice, and through the same agency "scrip vouchers" of £1, 10*s* and 5*s* could be bought, which could be used in the purchase of £5 and £25 denominations. The loan was a great popular success, 550,000 persons subscribing through the banks, and 47,000 through the postoffice.

A summary of loan operations in addition to the second war loan during the financial year ending March 31st, 1916, is as follows: the issue of £155,371,195 of Exchequer Bonds expiring December 1st, 1920; £493,427,000 of Treasury bills; £9,246,575 of "Other Debt", the nature of which is not specified, but which is known to be foreign borrowings; temporary advances of £19,896,000, known as Ways and Means Advances, which are actually an overdraft at the Bank of England based largely on 4% and 4½% time deposits of the clearing banks, and £51,369,863 from the Anglo-French $500,000,000 American loan.

(f) *Dollar Exchange*

The Anglo-French loan was floated principally to establish a credit in New York against future purchases so as to maintain the foreign exchanges. By the first of 1915 the $400,000,000 estimated annual debt of Americans to England had been expended or reinvested, and by July the current American indebtedness in London had been practically wiped out; speculative holdings in American securities liquidated, and many British-owned American securities sold. The Anglo-French commission reached America in October and began negotiations for a large loan secured by the deposit of American securities, but the continued fall in sterling exchange, which finally touched $4.49, caused the conclusion of the smaller unsecured loan, the proceeds of which were left in American banks to be drawn against in payment of English and French government purchases.

The loan was for $500,000,000 (British portion $250,000,000), bore interest at 5%, ran for five years, and was convertible into 4½% bonds payable in 15 to 25 years. It was issued at 96 to the underwriters and 98 to the public, making the yield at the first figure about 5¼%. It was easily taken, the underwriters generally preferring to hold their subscriptions for themselves.

The demand with which the commissioners had been met for the deposit of American securities as collateral led, however, to a plan for controlling the New York exchange by the use of English-owned American securities borrowed by the Treasury.[1] Their loan was at first optional, but in its final form the plan carried a penal tax on all securities not tendered to the Treasury. Under the single form finally adopted, the securities were borrowed for five years, although they might be returned on three months' notice after

[1] See chap. i, p. 50 *et seq.*

two years, and negotiable certificates were issued in their stead.

The plan worked well, bringing in approximately $1,300,-000,000 of American securities,[1] or practically all the standard negotiable American securities held in Great Britain, and enabling the exchange to be "pegged" at $4.76½. The "pegging" was effected by the Treasury's agents', J. P. Morgan & Co., taking all London exchange offerings at that figure. The declaration of war by the United States immediately relieved the British government of the burden of maintaining the exchanges by the sale of securities, as United States Treasury loans created the credits in America needed to pay for Allied purchases there. But the "peg" was kept in the exchange by the concentrating of the Allies' buying operations in the Treasury's agent in New York. Up to September 8th, 1919, the advances of the United States to Great Britain had totaled 888 millions sterling.

(g) *The Third War Loan*

The third war loan, issued in January 1917, came near the end of the financial year. The long period that had elapsed since the second loan had resulted in the growth of the total floating indebtedness to fifteen hundred million pounds, of which more than one thousand million pounds were in Treasury bills, and investors generally were looking for relief from such a mass of short-dated paper. The conversion of Treasury bills and Exchequer Bonds into bonds of the new loan reduced the floating debt to less than a thousand million pounds.

Further to relieve the situation, the public issue of Treasury bills was suspended from January 4, 1917, to the end of the financial year, considerably reducing the amount outstanding by the non-replacement of bills maturing during

[1] See chap. i, p. 56 footnote.

that period. The tender of £120,178,000 of bills as subscription to the war loan, and the cancellation of £41,347,000 others under the War Loan Acts of 1915 and 1916, further reduced the total, with the result that in spite of large issues in the earlier months of the fiscal year there was a net reduction of £110,772,000 as compared with March 31, 1916, the last day of the previous financial year.

Two forms of bonds were offered in the third loan, announced January 11, 1917, a 4% tax-free bond, issued at par, maturing in 1929 to 1942, and a 5% taxable bond, maturing in 1929 to 1947, issued at 95, and thus yielding 5¼%. Five per cent was payable on application and the remainder in even payments until May 30th. Owners of the second war loan and of 5% and 6% Exchequer Bonds might convert them at par, while holders of Treasury bills and War Expenditure Certificates might convert them at a discount of 5% for the first and 5½% for the second. Its conversion rights promptly sent the second loan to 99, while the fact that they did not enjoy conversion rights caused Consols to decline to 52¾ and the first loan to 84¾. One-eighth of 1% was to be set aside each month until £10,000,000 had been accumulated for the creation of a sinking fund to be used in purchasing the bonds whenever they fell below the issue price. This was a new departure in the history of England's war borrowing.

There was a general feeling that the third loan would be the last if the Allies won, and the last without compulsion if the war continued much longer — that, at any rate, the yield was the most advantageous that would be offered. So much, indeed, was intimated by the Chancellor, Mr. Bonar Law, in announcing it. Exchequer Bonds bearing 6% and Treasury bills bearing 5½% had been sold up to the very eve of the issue, and it was feared that because of this

prevalent high rate, deemed necessary in order to keep up the foreign exchanges, it would be difficult to float the loan.

Nevertheless, the loan was a great success. More than a thousand million pounds were subscribed, and conversion of earlier securities accounted for over £1,100,000,000 more. The banks and the postoffices together reported more than two million subscribers, and the Chancellor was able to say with gratification at the end of the subscription period that he had not had to appeal to the banks, which was certainly not desirable if it was not necessary. An additional £8,595,-371 was issued after April 1st to round up holdings. It is interesting to note that of the total amount applied for, only £22,000,000 or about 2% of the total, represented applications for the 4% tax-free loan.

(h) *Foreign Loans*

During 1916 two British loans, for $250,000,000 and $300,000,000 had been floated in the United States, and the Treasury in December of that year got possession of a further credit there of about $50,000,000 through a loan issued in Japan, which at that time had a large trade balance in the United States. A third loan, for $250,000,000 was floated in the United States during the latter part of January 1917, all three of these American loans being issued free of all British taxes. That issued in January 1917 was the last British loan offered to the American public, as after the entry of the United States into the war in April, all advances to Great Britain were made directly by the United States Treasury, the rate of interest being that which the loans floated in the United States bore.

The first of the three American loans was dated September, 1916 and matured September 1, 1918. It was for $250,000,000, bore 5% interest, and was secured by the deposit of Canadian, United States, and other foreign col-

lateral. It was underwritten at 98, and issued to the public at 99. Fifty millions of the amount was paid off when due by the sale of collateral, and the remaining 200 millions was paid by the Treasury's New York Agents, presumably from further advances by the United States Treasury.

The second loan was dated November 1, 1916, bore interest at the rate of 5½% and was in two forms; $150,000,000 maturing November 1, 1919, and issued at 99¼, and an equal amount due November 1, 1921, issued at 98½. It was secured by Canadian and American railway securities, with a very few British railway stocks added, and by government securities of British dominions, South American governments, Cuba, Japan, India and Egypt.

The third American loan, issued in January 1917, bore interest at the rate of 5½% and was secured by the deposit of $300,000,000 collateral, one-half consisting of stocks, bonds and other securities of American municipalities and corporations, Canadian Pacific Railway securities and bonds, and securities of the Dominion of Canada; and the other half of bonds and obligations of the other British colonies, Argentina, Chili, Cuba, Japan and bonds of Argentine and British railways, and of the Grand Trunk Railway Company. One hundred million dollars of the amount, due February 1, 1918, was issued at 99.52 and the other hundred and fifty millions, due February 1, 1919 was issued at 99.07. Practically all of the notes due in 1918 were paid off out of fresh advances from the United States Treasury, while most of the holders of the 150 millions due February 1, 1919, took advantage of the option—open to holders of the one-year notes as well—to convert into 20-year 5½% bonds due February 1, 1937.

The following table gives the particulars of all British War loans publicly issued in the United States:

Nature of Loan	Amount $	When Issued	Rate of Interest %	Issue Price	Date of Maturity
British portion of Anglo-French loan (no collateral)	250,000,000	Oct., 1915	5	98	Oct. 15, 1920
2 yr. Coll. Notes	250,000,000	Sept., 1916	5	99	Sept. 1, 1918
3 " " "	150,000,000	Oct., 1916	5½	99¼	Nov. 1, 1919
5 " " "	150,000,000	Oct., 1916	5½	98½	Nov. 1, 1921
1 " " "	100,000,000	Jan., 1917	5½	99½	Feb. 1, 1918
2 " " "	150,000,000	Jan., 1917	5½	99	Feb. 1, 1919
*3 " " " ...	250,000,000	Nov., 1919	5½	98	Nov. 3, 1922
10 " " " ...			5½	96¼	Nov. 1, 1929
Total.	1,200,000,000				

* Refunding Loan.

Besides these foreign loans and the third war loan, the year 1916-1917 was financed—aside, of course, from revenue—by the issue of £256,563,610 of 5% Exchequer bonds, £161,000,475 of 6% Exchequer Bonds, £73,099,825 of war savings certificates, and £29,878,500 war-expenditure certificates, and by "temporary advances" of £197,630,000.

War Savings Certificates were purchasable at postoffices and banks. The postoffice issued certificates for sums of £1 to £500, the purchase price being respectively 15/ 6*d* and £387. 10. 0. No income tax was deducted from or charged upon the interest earned by War Savings Certificates, and they were repayable in 5 and 10 years, but repayment of the whole, or part, might be claimed beforehand. Aggregate sales of War Savings Certificates amounted on September 27, 1919 to £362,217,260.

(i) *Continuous Borrowing*

The loan of January 1917 was the last fixed subscription period loan issued in Great Britain until the Victory Loan of 1919. The policy of a continuous and unlimited sale of

bonds was in force from October 1917 until the second issue of National War Bonds was withdrawn on May 31, 1919. With these continuous issues of bonds were of course maintained the sale of Treasury bills and War Savings Certificates.

"National War Bonds", as they were called in distinction to the previous issues, were placed on sale October 2, 1917, at which time the floating debt was £1,170,000,000. There were four forms of "National War Bonds":

5% taxable bonds, repayable October 1, 1922 at 102
5% taxable bonds, repayable October 1, 1924 at 103
5% taxable bonds, repayable October 1, 1927 at 105
and
4% income tax exempt bonds, repayable October 1, 1927 at par.

Interest was payable half-yearly, and the bonds were issued in denominations as small as £50; were convertible into future loans at par, and were acceptable in payment of death duties, excess profits duty, and munitions Exchequer payments, though this right was denied to foreign holders and to persons not commonly resident in the United Kingdom. Conversion of the new bonds into former war loans, and of former loans and Exchange Bonds into the new issue, were provided for. When the sale was announced there was again threat of compulsion if the issue was not subscribed as expected, and the *Times* of November 28th observed that "those who keep their money back when it could have been placed patriotically on so favorable a basis may well find that the alternative is distinctly less attractive."

The advantages of financing the War on such a method of borrowing, if it could be made to bring in enough money, were of course expected to be the drawing from the actual savings of the people for the country's expenditures, instead of depending on the creation of banking credit for the taking of a loan. Securing the enormous sums necessary each

week was not so difficult as would have appeared at first glance, for the restrictions on the issue of new capital had left almost no outlet for investment funds except government issues.

Not until January 18, 1919, was the issue finally withdrawn, and then only to give place to a new series which appeared on February 1st. The bonds were on sale for 68 weeks, and a total of £1,645,337,734 was subscribed, a little less than the 25 millions a week which the Chancellor thought would be necessary when the issue was inaugurated. In fact, if war savings certificates purchased during the period are included, the total was over the estimated requirement. Aside from very efficient advertising and propaganda methods, it is certain that the reduction of the rate on Treasury bills and of the maximum Bank deposit rate had much to do with their success.

The second issue consisted of 5% bonds, subject to income tax, for five and ten years, and 4% tax-exempt ten-year bonds. The 5% bonds were issued at par, and the 4% at 101½, the redemption prices being the same as for the previous issue; namely 102 for the five-year 5%, 105 for the ten-year 5%, and par for the 4%. The seven-year bond was dropped, and the bonds of the second issue carried no rights of conversion into past or future bonds. Somewhat less than 90 millions were sold during the four months they were on sale.

(j) *The Victory Loan of 1919*

On May 31, 1919, Treasury bills and the second issue of National War bonds were withdrawn from sale in preparation for the funding loan. On June 2nd, Mr. Chamberlain, the Chancellor, requested permission of the House of Commons to issue a loan which he said was to be primarily a funding loan. There was needed about 250 million pounds, to make up the anticipated deficit in the Budget for the year

1919-1920; the floating indebtedness was about one thousand, five hundred millions, consisting of £1,036,000,000 of Treasury bills and Ways and Means Advances amounting to 460 millions; in addition to these, there would mature in October 1919, 245 millions of Exchequer bonds. If the coming loan was to fund the floating debt, make provision for the new money necessary to run the government, and take up maturing Exchequer bonds, two thousand million pounds would have been necessary.

The subscription period of the loan opened on June 12, 1919. It was offered to the public in two forms, a 4% "Funding Loan", issued at 80, and redeemable at par from 1960 to 1990; and 4% "Victory Bonds", issued at 85, and redeemable at par by annual drawings commencing September 1, 1920. The sinking fund from which the Victory Bonds are to be redeemed was so arranged that half of the Bonds will be retired within 42 years, and all within 56 years, or by 1975. The yield to the investor will of course vary with each type according to the date of redemption, but assuming 1975 as the mean redemption date for the Funding Loan, it will amount to about 5.1% while the average yield of the Victory Bond will be 4.85%.

In the case of both types, the government undertook to set aside each year 4½% of the nominal original amount of the loan, the amount remaining from which, after meeting interest charges, to be set aside as a sinking fund. That for the Funding Loan was to be used for the purchase on the market and retirement of the securities, if below par. The sinking fund for the Bonds was to be used each year to redeem as many of them as possible at par, the bonds to be so redeemed to be determined by drawings.

Although the theoretical yield of the Bonds was less than that of the Loan, the chance that his particular bonds might be among those redeemed soon was attractive to the instincts

of the British investor, while they possessed the positive advantage of being acceptable for death duties at par, while the Bonds were made acceptable only at their paid-up cash value, 80%. Persons desirous of leaving adequate provision for payment of such duties, without necessitating the sale of part of their estate, were sure to appreciate this feature.

All conversion pledges made in connection with previous loans were upheld, and issues which did not enjoy the privilege of conversion into the present one, like Consols and the 5% War Loan of 1917, declined in comparison when the loan was announced. Interest on the holdings surrendered was to be paid up to June 21, 1919, and in the case of the 6% Exchequer Bonds due in February 1920, an additional payment was to be made representing interest at 1% from June 21 to February 16, 1920.

III. THE EFFECT OF THE VICTORY LOAN ON THE FLOATING DEBT OF GREAT BRITAIN

The estimate of £500,000,000 of new money — that is, subscriptions not covered by the conversion of former loans—was not realized by the Victory Loan. Including the postoffice issue, the cash applications, in which the Treasury bills were included, reached £287,956,000 for the Funding Loan and £286,748,000 for the Victory Bonds—making a total face value of £574,704,000. At the issue price of 80 and 85 respectively, this represents £474,092,000 received in fresh money. The conversions were £120,617,000 of Funding Loan, and £72,203,000 of Victory Bonds. It was stated by the Chancellor of the Exchequer that bank subscriptions amounted to £37,692,000 for the Funding Loan and £73,351,000 for the Victory Bonds, a total of £111,000,000. This of course detracted greatly from the success of the loan since its purpose was to reduce the government's floating debt largely held by the banks. The loan reduced

the floating debt of £1,500,000,000 little more than one-fourth. Under these conditions it could hardly be regarded as a great success.

IV. FURTHER MEASURES FOR REDUCTION OF FLOATING DEBT NECESSARY

Additional bond issues would therefore be necessary if the whole or a considerable part of the floating debt was to be eliminated. The alternative to this was the issue of Treasury bills to take the place of maturing Treasury bills for an indefinite period. Since Treasury borrowings during the war dominated the discount market and took practically all the funds normally available for financing trade, it was essential that Treasury bills be reduced as rapidly as the expansion in trade made necessary the use of these funds for commercial purposes.

The government's expenditures had not been cut down materially. The revised 1919-20 budget estimate of the Chancellor of the Exchequer in October 1919 showed an increase in the estimated deficit of £250,000,000, and the floating debt was almost as large as it was when the Funding Loan of July 1919 was floated. As long as the government remained an active competitor for funds needed for the financing of reviving trade, a new era of inflation was imminent.

The reissue of Treasury bills by the Bank of England after the closing of the Funding Loan subscription period of July 12, 1919 was on the same basis as before June 1st; that is, bills were issued in indefinite quantities upon application at the Bank. The only change was that 2-month bills were offered yielding 3⅜ per cent, and 6-month bills yielding 4 per cent. On October 5th the 6-month bills were raised to 5 per cent, and on November 7th to 5½ per cent. The 2-month bills were to supply the market with Septem-

ber bills. The increased interest was a departure which indicated that the Treasury was preparing to take off controls on money and make its rate what the market rate would be in competition with commercial bills.

V. MEASURES OF TREASURY DE-CONTROL

An important step was taken in July 1919 in the direction of de-control. The clearing banks on July 21st received an intimation from the Bank of England that after July 23rd it would discontinue the practice of allowing 3 per cent on three-day deposits made by the clearing banks. This it did. The Bank continued for a time after this date to pay 4½% on foreign balances,[1] though there could be no advantage in this from the standpoint of the exchange except in regard to American money, for sterling exchange was at a premium with practically all countries but the United States.

This step indicated the Government's policy to reduce Ways and Means Advances and as soon as possible discontinue this form of government borrowing. It was a step in the right direction. Ways and Means Advances had been the principal cause of currency expansion. Their elimination would free bank deposits from governmental control and render them available for commercial use.

The whole situation, as far as government financing was concerned, was absolutely artificial and the rate had been fixed by Treasury control of the money market. The release of this control would tend to cause the market to seek its natural level, which quite clearly would be higher than the level established by the action of the government. The government was maintaining its floating debt at 3½ per cent, and paying five and a fraction on its Victory Loan. The tendency of money rates everywhere was upward and they were maintained at a low level in Great Britain through

[1] Discontinued October 19, 1919.

Treasury control carrying with it necessity for inflation of the currency and of credit. Low rates secured in this way are of doubtful advantage. The Treasury found it difficult to release some restrictions without releasing all, but a beginning had to be made. Though it was desirable that all should be released and that restrictions on gold exports should also be removed, it is equally true that this could probably not have been done precipitously without serious danger.

VI. GOVERNMENT FINANCE AND INFLATION

To understand the British government's policy of war finance it is necessary to bear in mind that the London money market on August 1st, 1914 was wholly unready for such an emergency, and that the policies adopted were dictated by the belief that the war was to be of short duration. Methods which led to serious inflation, because of the cumulative effect of being continued for a long time, would doubtless have been the most expedient for the financing of a short war. In a word, the slogan of " Business as Usual ", which caused great delay in getting the country down to quantity war production, prevailed also in the field of finance, and consequently too much dependence was placed upon the financial system rather than upon the savings of the people for the conduct of the war.

When war was declared the country, as pointed out by Mr. Asquith, was confronted with a shortage of internal currency; that is, legal tender money. The assets of the banks were not sufficiently liquid, the credit of the country in the form of deposits being to too great an extent tied up in investments. Though the Bank Act was suspended, permitting the issue of Bank notes in excess of the legal maximum, this meant a 10% rate to prevent the drain of gold, with the consequent high cost of financing war, industry

and trade. Hence a new expedient was decided on; namely, the issue of currency notes, which were treated as direct advances by the Treasury to the banks, bearing interest from day to day at the current Bank rate, and secured by a floating charge on the bank's assets. This supply of currency was necessary to meet the immediate needs of the situation, but because of the terms of its issue, as described in the first chapter, it was a fruitful source of inflation as the war progressed.

The belief in a short war encouraged the various Chancellors to finance loans largely through the banks rather than face the necessity of raising the rates of interest as increased expenditures necessitated inducements for increased saving on the part of the public. The Chancellors, Messrs. Lloyd George, McKenna, and Bonar Law, each realized the importance of saving, particularly Mr. McKenna, who in issuing the second war loan provided for a 4½% rate as against the 3½% rate of the first loan. Further, he gave subscribers the right of receiving by conversions the higher rate of interest that might be paid on any future loans. He also provided that the Consols and the first war loan might be converted into the second war loan in pursuance of this same policy.

Because of delays in getting out the third loan and the financing of the war in the interval by short-dated obligations, the money market was utilized rather than the savings of the people, and the money market, as we have pointed out, was dominated by the government itself; in fact, consisted to a large extent of government-created credit. For the whole period, therefore, between the second and third war loans, namely, from July 1915 to January 1917, the war was financed to a very large degree by funds *created* by the Treasury itself and the banks.

This policy met in general with the approval of the finan-

cial interests of the City, who were emphatically opposed to a policy of increased rates on government borrowings because this would depreciate the value of existing securities. The City, therefore, through its influence upon the Chancellors, chose a policy of inflation as an alternative to depreciation in the value of all fixed interest-bearing securities. The attitude of the City on this question was quite clearly brought out by its opposition when the Chancellor raised the rate on Exchequer Bonds to 6% in October 1916. The bankers found that by taking the responsibility of financing the expenditure of the war themselves, the rate of interest could be prevented from rising, and as it appeared on the face of it to be a good policy for the government to borrow at a low rate, little heed was paid to the few who protested and urged that the low rates were secured at the price of a dilution of the currency and of bank credit. It is always difficult for the public to realize that inflation is a charge against the future, and that a low rate of interest, secured through the expedient of inflation, is in effect not a low rate at all.

The next loan (the Third War Loan) was for 5%, 1% less than that paid on a previous issue of Exchequer Bonds. It is in connection with the issue of this loan that the intimation was given respecting the establishment of a maximum rate of interest to be allowed in future on government loans. Mr. Bonar Law was Chancellor, and attributed the great success of the loan to the patriotism of the people, to which great appeals were made. Since the implied threat of compulsion if future loans proved necessary and the patriotic appeal were new elements in the situation, it may be assumed that the rate of interest had little to do with the success of the loan, and that a lower rate might have made small difference in the amount of the subscription. The City was satisfied, in any event, so long as a rate higher

than 5% was not established and securities depreciated. The trouble with the expedient of forced loans is, however, that the burden of financing the loans will fall on the financial machinery of the country rather than come out of the savings of the people. And in so far as the financial machinery had to carry loans through at artificial rates it did this by still further dilution of the currency and inflation of credit.

A critic of the government's financial policy observes: "The matter of the people's savings was relegated to economy campaigns, by which a considerable measure of success was achieved in promoting thrift and investment, but nothing nearly commensurate with the needs of the situation, nor anything like what might have reasonably been expected if the virtual promise made by Mr. McKenna of higher rates of interest had been rapidly fulfilled."[1] The financial machinery, consisting of the Treasury's printing press, the Bank of England's Ways and Means Advances, and the joint-stock banks' credit expansion, formed a system which was the main reliance of the government for floating loans, both short term and long. This machinery resulted, points out the critic quoted above, in the country's currency system, particularly the check currency, being diluted much beyond what might be regarded as normal in financing the immense purchases necessary to carry on the war.

The Chancellor of the Exchequer, Mr. Chamberlain, in his introduction of the 1919-1920 budget, stated that the amount of legal tender in the country, which was estimated to have amounted in the beginning of the war to about 214 millions, was then two and one-half times that, or 541 millions. Bank deposits, which totaled £1,070,000,000 at the close of 1913, had risen by the end of 1918 to about two

[1] "Our Financial Policy and the Rate of Interest," *Anonymous*, P. S. King & Sons, London, 1917, p. 5.

thousand million.[1] Total currency notes in circulation on October 1st, 1919 were 335 millions, with a gold reserve of 28½ millions, and a Bank of England note reserve of £1,-350,000. The extent to which bank credit was being used to finance the government after the armistice is shown by the fact that there was on June 4th, 1919 a floating indebtedness of about £1,500,000,000, made up of £1,036,000,000 three and six month Treasury bills and of Ways and Means Advances, which were simply overdrafts at the Bank of England, amounting to £4,60,000,000. The funds which the banks used for investment in Treasury bills, and the surplus balances which they deposited with the Bank of England at 3%,[2] and which were the theoretical basis of the Bank's Ways and Means Advances to the government, were in both cases credit created by the government itself. The Treasury issued to the joint-stock banks through the Bank of England currency notes to any extent that the banks might demand them. There was a theoretical limitation of 20% of the banks' deposit liabilities, but since the process of issuing notes had the effect of increasing deposits, the 20% limit, large to begin with, was constantly increasing. The payment of interest on these currency advances was exacted by the Treasury for only a few months after the war began, so that the banks could get all the currency notes they could use without cost and almost without limit. Early in the war they took fairly large amounts but gradually as the circulation increased they liquidated their accounts with the currency note account, and drew notes as they needed them, by checks against their accounts at the Bank of England.[3] When it is

[1] See Report of the Committee on Financial Facilities. Cd. 9227, par. 22.

[2] Cd. 9182.

[3] In the first few months of the war, nearly £13,000,000 were advanced to the banks, but the amount was quickly reduced and throughout most of the war stood at less than £1,000,000.

borne in mind that these accounts were not increased by deposits of gold, as formerly, but by the government's own checks on the Bank of England in favor of contractors, etc., it can be seen that the government was in effect giving its credit in exchange for the banks' credit, and until July 1919, paying the banks 3 to 3½% besides.[1] Since the notes were and still are legal tender, and theoretically redeemable in gold at the Bank of England (theoretically because gold exports were prohibited, and the Bank would practically refuse to pay out its gold for these notes if anyone should demand it), they could be held in lieu of gold in the joint-stock banks' reserves, and thus become the basis for the issue of four or five times as much bank credit.

As has been pointed out elsewhere, the various devices of currency notes, Ways and Means Advances, interest on surplus balances, Treasury bills, and absorption by the banks of long-term loans (in so far as it took place) were simply different phases of a process of creating money out of air. The process is described as follows in a footnote in the First Interim Report of the Committee on Currency and Foreign Exchanges after the War:

> This process has had results of such far reaching importance that it may be useful to set out in detail the manner in which it operates. Suppose, for example, that in a given week the government require £10,000,000 over and above the receipts from taxation and loans from the public. They apply for an advance from the Bank of England, which by a book entry places the amount required to the credit of Public Deposits in the same way as any other banker credits the account of a customer when he grants him temporary accommodation. The amount is then paid out to contractors and other government creditors, and passes, when the checks are cleared, to the credit of their bankers in the books of the Bank of England—in other words, is trans-

[1] Interest discontinued July 23rd, 1919.

ferred from Public to " Other " deposits, the effect of the whole transaction thus being to increase by £10,000,000 the purchasing power in the hands of the public in the form of deposits in the joint-stock banks and the bankers' cash at the Bank of England by the same amount. The bankers' liabilities to depositors having thus increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war something under 20 per cent) is improved, with the result that they are in a position to make advances to their customers to an amount equal to four or five times the sum added to their cash reserves, or, in the absence of demand for such accommodation, to increase their investments by the difference between the cash received and the proportion they require to hold against the increase of their deposit liabilities. Since the outbreak of war it is the second procedure which has in the main been followed, the surplus cash having been used to subscribe for Treasury bills and other government securities. The money so subscribed has again been spent by the government and returned in the manner above described to the bankers' cash balances, the process being repeated again and again until each £10,000,000 originally advanced by the Bank of England has created new deposits representing new purchasing power to several times that amount. Before the war these processes, if continued, compelled the Bank of England . . . to raise its rate of discount, but . . . the unlimited issue of Currency Notes has now removed this check upon the continued expansion of credit.

The government's liberal creation of credit, and its policy of paying the banks interest on the surplus balances which resulted largely from this operation, had the effect of making the Bank of England's discount rate practically inoperative. This policy fixed the rate of interest in the market, because the banks would not lend call money or discount bills at a rate less than that obtainable at the Bank. The Treasury, however, was in the position of wishing to keep the

domestic rate low, in the interest of war financing, and at the same time of not having it so low that foreign balances would be withdrawn and sterling exchange depreciated.[1] The manipulation of the market in the interest of low rates tended to make the machinery work adversely so far as the foreign deposits were concerned. Though the Bank rate fluctuated during the war, its inability to perform the two-fold function of giving low rates at home and attracting foreign deposits caused it finally to be in effect discarded as an instrument of control, and a 3% rate for domestic money, and a 4½% rate for foreign money, established.

On the whole England did little directly to create currency in the shape of notes, particularly if allowance be made for the substitution of notes for sovereigns; bank currency was created chiefly by bank advances. This was connected to a considerable degree with the issue of big loans, and could to some extent have been avoided had the method of continuous borrowing been more strictly adhered to.

The outstanding feature of British war finance, from a practical standpoint, was the remarkable success of the Treasury bill. This applies more especially to the system of continuous issue at fixed rates; which had the great merit of suiting the convenience of the money market, and at the same time giving an effective control over the market rate of discount. As has been said, these bills were at times current to an amount of £1,000,000,000 without any of that disturbance which a loan of the same amount would cause.

Summing up the matter, the joint-stock banks' cash reserves were increased by the expansion of credit by the Bank of England. The major part of the credit, which the Bank loaned to the government as Ways and Means Advances,

[1] Though sterling exchange was "pegged" in New York, the withdrawal of foreign balances on a large scale would have enhanced the difficulty of maintaining the "peg".

and on which the Bank paid 3% or more interest to the joint-stock banks, was ultimately transferred to the account of the joint-stock banks at the Bank of England. The subsequent disbursement of such borrowings, and the building up of additional legal reserves in hand by the joint-stock banks in the form of currency notes, and the use by the government of the credit thereby created, carried the process along. No part of the increase was due to excess deposits over withdrawals of legal tender by customers of the joint-stock banks, for, on the contrary, there was an almost continual absorption of the legal tender by the public from the commencement of the war, owing to rapidly increasing commodity prices and wages.

The Bank of England's weekly statement does not disclose anything of the operation of currency-note advances to the banks, or of Ways and Means Advances. However this record was kept, it remained a mystery to the bankers and the public. The whole process was little different from the issue of the Treasury notes by the United States Government at the time of the Civil War. The difference seems to be simply that the British Government sought to throw a curtain over the machinery by which notes were put into circulation to pay for government purchases and enlarge bank reserve for the securing of bank credit. In the case of both the "greenbacks" and the currency notes, the gold standard was given up and the exchange fell.

VII. PEACE FINANCE AND THE FUTURE

The end of the war meant by no means the end of wartime finance, and indeed, the expansion of banking figures went on at an even accelerated pace, for besides the aftermath of government expenditure in the shape of demobilization expenses, army of occupation, etc., there was all the credit required by industry to reorganize it and get it working on a peace basis.

The yearly increase in the deposits of the principal English banks is shown in the following table:

Amount:	June 30, 1914	751.0
Increase	" " 1915	196.6
"	" " 1916	44.5
"	" " 1917	81.1
"	" " 1918	282.5
"	" " 1919	406.2
Total increase		1010.9

Thus during the five years there was a total increase of 134.6%. The total increase in assets was 1039.1 millions, as follows:

	£ *million*
Treasury Notes Bank of England Notes Credit at Bank of England	224.85
Investments	224.8
Loans Discounts and Advances	589.8
	1039.1

Summary of War Time Finance

August 1, 1914 to September 30, 1919

(Million £)

Legend	Aug. 1, '14 to Mar. 31, '15.	Apl. 1, '15 to Mar. 31, '16.	Apl. 1, '16 to Mar. 31, '17.	Apl. 1, '17 to Mar. 31, '18.	Apl. 1, '18 to Mar. 31, '19.	Aug. 1, '14 to Sept. 30, '19.
Raised by Revenue	171.76	336.77	573.43	707.23	889.02	3137.21
Net Borrowings	404.99	1164.52	1625.55	1983.58	1682.05	7133.71
Total Income	576.75	1501.29	2198.98	2690.81	2571.07	10271.5
Total spent	498.36	1559.16	2198.11	2696.22	2579.30	10270.92
Increase and Decrease in Exchequer Balance	+78.39	—57.88	+.86	—5.41	—8.23	—.58
Total	576.75	1501.29	2198.98	2690.81	2571.07	10270.92

VIII. GREENBACKS AND BRADBURYS

As has been pointed out above, the method and purpose of currency creation in Great Britain during the World War and in the United States during the Civil War were much the same. Because of this fact, it will be of interest to compare these two situations and to take note of their similarities and contrasts. The present section therefore undertakes an analysis of the terms, conditions, and purposes of the greenback issues as contrasted with the British treasury issues, popularly referred to in England as the Bradburys.

In both cases the governments had recourse to the issue of legal tender, non-redeemable paper money, which resulted in the abandonment of the gold standard and brought about serious inflation with its evil effects on prices and war costs. The manner of the issue was somewhat different, but the general consequences were the same. As a contrast, it might be said that the British Government inflated more efficiently. The treasury notes, or Bradburys, as has been pointed out, were in reality an expedient by which credit inflation was made possible. The notes, as circulating media, served primarily the purpose of replacing the gold that had been withdrawn from circulation, and of supplying the increased currency requirements that high prices brought about. The greenbacks, on the other hand, were the immediate and direct cause of high prices. There is little evidence of bank inflation as such—certainly nothing analogous to the British situation of large bank-credit creation brought about through central bank overdrafts, and the pyramiding of these throughout the whole banking system. The independent treasury system in the United States made this impossible. Of course some credit creation took place, for additions to the legal tender supply had their influence on bank reserves, but the Civil War inflation was primarily and almost en-

tirely a currency inflation. This was due not only to the independent treasury system but also to fundamental differences in banking method. The banks of the United States operated at the time on the currency principle: that is, loans meant currency creation rather than deposit creation. The evolution of banking has put the emphasis today on the latter. This is particularly true in Great Britain and the United States, where bank checks are the principal currency medium. Hence the divorce of the Civil War government's financial machinery (the independent treasury system) from the banking system, and the inherent difficulty of bank-credit expansion, limited inflation almost wholly to currency inflation. It has been pointed out above[1] that the deposits of the principal English banks increased between June 30, 1914 and June 30, 1919, by 1010.9 million pounds, or 134.6 per cent. That was about three times the amount of the currency increase.

Had the Civil War government been able to bring about an inflation of bank deposits in the same manner and to the same degree that the British Government did in the Great War, there would either have been greater advances in prices, wages, and war costs than there were, or inflation would have been divided between bank deposits and notes, with a resulting smaller issue of the latter. In view of the opposition to the greenback issues, and in view of their cessation in March, 1863, despite ample excuse for printing more after that date, it would seem that this is not beyond the range of possibility. There would have been definite advantages in this, since bank credit is more elastic both in expansion and contraction. Financial mobilization at the outbreak of the Civil War could have been effected more quickly, bond issues floated more readily, and the war prosecuted more vigorously, had Secretary Chase been able and

[1] See p. 151.

willing to bring Treasury and banks into close working agreement.

It was theoretically possible to have conducted both wars with little or no inflation, if drastic taxation had been imposed at once and goods conscripted as well as men, but if the necessity of inflation is conceded, there is much to be said in favor of the British method as against our own in the two war crises. We succeeded as badly in borrowing as we did in taxation, whereas Great Britain had no great difficulty in the former. Never were actual funds lacking to prosecute the war. Our Treasury, on the other hand, was in almost constant embarrassment for funds; public confidence in the government was repeatedly shaken; and war morale was frequently at a low ebb because the Treasury groped and struggled with changes in plan and purpose. Borrowing success during the Civil War was further impeded by Secretary Chase's unwillingness to sell bonds at market rates. The British Government inflated the currency to keep interest rates low, but nevertheless did not hesitate to offer issues at a discount. Secretary Chase, however, persistently refused to do this, and thereby added greatly to the problem of successfully floating loans.

(a) *The Greenback Issues*

The history of the currency issues in Great Britain has been given in the first chapter, and the necessity of some new emergency currency as part of the plan of financial mobilization has been conceded. Criticism has been based on the extent to which inflation was allowed to take place, and the unrestrained credit expansion that was fostered by the Treasury. More drastic taxation and more immediate and thoroughgoing control of prices and wages would have made possible smaller war costs and quicker post-war economic adjustments. It must be said in the case of both

governments, however, that the belief in a short war was firmly fixed, and criticism of policies and methods must be tempered accordingly. It is the general opinion of students of Civil War financial history that the issue of the greenbacks might easily have been avoided had there been, in the years immediately preceding the war and during the war itself, able, efficient direction of the Treasury. It is true that Secretary Chase and a strong group in Congress at first vigorously opposed the issue of irredeemable paper money, but the alternative of drastic taxation was not seriously faced.

Great Britain was in excellent financial condition in 1914, and in a better position to meet the crisis of a stupendous world war than was the United States in 1861, faced only by the financial necessities and strain of a relatively small war. Our Civil War government came into existence confronted with serious fiscal problems, and drifted into a position where greenback issue became imperative. The British Government acted with quickness and decision in a financial crisis far more serious. The Treasury Department under the Buchanan administration, just preceding the Civil War, had been badly managed. Continued borrowings to meet annual deficits characterized its policy. The government was forced to pay 12% on a $10,000,000 loan in 1860. When General John A. Dix became Secretary of the Treasury on January 11, 1861, a few months prior to President Lincoln's inauguration, he found the treasury empty, $300,000 of unpaid warrants accumulated, and a deficit which was expected to reach $27,000,000 by the end of the fiscal year June, 1861. The reasons for this were the election of President Lincoln in November, 1860, which had resulted in the withdrawal of funds by the Southern banks, and the business depression which the imminence of the war brought about and which affected customs revenue—the principal source of

government income. Although certain duties were increased by a new tariff act which went into effect two days after the close of President Buchanan's administration, duties were not imposed on those staples from which large returns would have been received, and as a revenue measure the new tariff was a failure. In fact, this act caused a 40% decrease in revenue for the second quarter of 1861 as compared with the quarter preceding. Nor were other types of taxation as yet given serious consideration. Instead, almost every conceivable method of borrowing was tried, but with little success. Borrowing became inherently more difficult with an empty treasury and rapidly increasing deficits.

Secretary Chase therefore faced a serious situation when he took office on March 7, 1861. A war was inevitable, in which large expenditure would be necessary, yet the government was finding it difficult to meet peace-time outlays. Hostilities began in April, 1861, and a special session of Congress was called on July 4th, at which President Lincoln called for "at least 400,000 men and $400,000,000." Secretary Chase in his report at this session estimated government expenditure for the coming twelve months at $320,000,000. He proposed to meet peace-footing expenses by augmenting taxation, and war outlay by borrowing. The former he estimated at $80,000,000, and the latter at $240,000,000. His plan was accepted by Congress, and loans and increased customs duties were authorized. In January, 1862, Congress announced its intention of increasing taxes to a basis of estimated return of $150,000,000 per annum. The plan included not only increased customs duties but excise duties as well. Income taxes had been authorized on August 5, 1861, but yielded little until the fiscal year 1864. The return from taxation as a whole was also disappointing, being only $50,851,729 for the fiscal year 1862. This was due to the depression in business, to

military reverses, and to the confusion and ineptitude of the Treasury Department itself. For the same year loans, including treasury notes, were $433,663,538. This was a ratio of loans to taxation of 8.51 to 1.00.[1]

It will be seen that the matter of taxation during the first year of the war, as a reflection of government credit, was an important factor in the situation which led to the issue of treasury notes, but very much more important was the suspension of specie payment by the banks on December 30, 1861. This, however, was the inevitable outcome of the policy of Mr. Chase himself. The loan bills of July 17 and August 5, 1861, empowered the Secretary to borrow not exceeding $250,000,000 in three-year 7.3% treasury notes or in twenty-year bonds not exceeding 7%. He was also authorized to issue as part of this loan, under certain limitations and to an amount not exceeding $50,000,000, non-interest bearing demand notes or one-year notes bearing interest at 3.65%. These latter the Secretary began to issue. Unlike the greenbacks subsequently authorized, they were payable on demand in gold at the sub-treasuries and receivable for taxes and customs duties. Despite these features, they were received with reluctance by the banks. The latter feared the effect on their own issues because the notes could be deposited and specie withdrawn, thus weakening their own reserves. They received them, therefore, only on "special account." They also feared the effect of a large amount of such demand obligations on the treasury's solvency.[2]

Still more embarrassing to the banks was the Treasury's attitude in the matter of selling the bonds authorized by the acts just referred to. The sale of the bonds without the

[1] Davis R. Dewey, *Financial History of the United States*, p. 299.

[2] Wesley C. Mitchell, *History of the Greenbacks*, pp. 26-27.

cooperation of the banks was impossible. Representatives of certain banks in the large Eastern cities undertook to underwrite the first loan of $150,000,000. The task was a difficult one, as the combined capital of the group was only $120,000,000, and their coin assets only $63,000,000. It was difficult but possible, had the Secretary construed the Act of August 5, 1861, as giving him the power to leave the proceeds from the sale of the bonds by the banks on deposit with the banks, and to check against them for government disbursement. Specie was being hoarded and was scarce, but deposit credit could safely have been expanded. Mr. Chase would not interpret the law as permitting this, and insisted on transfers of specie to the sub-treasuries upon the sale of the bonds. As disbursements were made from the sub-treasuries the specie was still further hoarded and did not reach the vaults of the banks. The more bonds the banks sold, therefore, the lower went their reserves. Consequently, Mr. Chase's policy of maintaining the independent treasury system and issuing gold demand notes so embarrassed the banks that on December 30, 1861, they were forced to suspend specie payments. The government had of necessity to do likewise. There were $33,460,000 in demand notes in circulation at the time of the suspension.[1]

It will be apparent that the stage was set for the issue of legal tender notes early in 1862. Secretary Chase recommended the organization of a national banking system, and the issue of bank currency based on government bonds, but his recommendations were ignored. A sub-committee of the Committee on Ways and Means, under the chairmanship of E. G. Spaulding of New York, proposed the Legal Tender Act of February 25, 1862, and secured its passage over considerable opposition. This act authorized the issue of

[1] Davis R. Dewey, *Financial History of the United States*, p. 278 *et seq.*

$150,000,000 of notes, which were declared to be "lawful money and a legal tender in payment of all debts, public and private, within the United States, except duties on imports and interest on the public debt," which were expressly made payable in coin. The notes were also exchangeable for 6% five-twenty bonds, and might be deposited at 5% interest in any designated government depository. No provision was made for repayment and no pledge against further issue was given.[1] Once the first issue was made others followed in quick succession and with little opposition. The second issue was authorized July 11, 1862, and was for $150,000,000. On January 3, 1863, or within a year, there was authorized a third for $100,000,000 which was increased on March 3, 1863, to $150,000,000, making in all a total of $450,000,000. Some fractional currency and short-time interest-bearing notes, which were likewise legal tender were subsequently added.

(b) *Civil War Prices Due to Monetary Causes*

As reflected in extensive gold dealings during the Civil War, there was a divergence between the general level of prices as expressed in greenbacks and the level of prices translated into terms of gold. There were but two elements in the recent British price situation, the wholesale index and the exchange rates, but in the United States there were three: the wholesale level of prices, gold prices as reflected in the gold market, and the exchange rates. It is true that gold values and exchange rates could not vary greatly because of the ever-present alternative of gold imports or exports, but there were gold fluctuations out of line with exchange rates induced by speculative factors and market sentiment.[2] In

[1] For a complete discussion of this subject see Wesley C. Mitchell, *History of the Greenbacks.*

[2] Wesley C. Mitchell, *History of the Greenbacks*, p. 189 *et seq.*

Great Britain, treasury notes were acceptable for all payments, both private and governmental, and gold exports for private account and the charging of a premium on gold were prohibited.[1] In fact, since the treasury notes were full legal tender and it was impossible legitimately to make a profit by gold exportation, gold had no practical advantage over the notes as money. It was hoarded to some extent, but through patriotic appeals, which had compelling force because of the vital necessity of imports to prevent defeat at the hands of Germany, the people readily paid their gold into the postoffice and treasury for the government's use. Their action in this was along the lines of their sacrifices in turning over their foreign securities to be used in borrowing operations to effect the same purpose.[2] The American government during the Civil War made a gold market necessary because the public had to have gold to import goods; i. e., to pay duties and make foreign remittances. Dealings in futures were essential for the same reason. This was emphatically demonstrated when the "gold bill," passed June 17, 1864, to prevent dealing in gold futures produced such confusion that it had to be repealed July 2, 1864, fifteen days after its passage. Regular dealing in gold began on the New York Stock Exchange on January 13, 1862, shortly after the suspension of specie payments and before the greenbacks were issued. The Gold Room was established on New Street, next door to the Stock Exchange, and in October, 1864, a constitution and by-laws were adopted and regular officers elected. In addition to this there were also two other markets—the open board and, for a time, Gallagher's evening exchange.

A close study of the two periods will reveal certain interesting contrasts in the effect of government financial

[1] See p. 39.

[2] See p. 50 *et seq.*

policy on prices. With respect to the Civil War period, Professor Mitchell has demonstrated that "monetary conditions preponderated over all other factors as a price determinant."[1] Gold was at a premium from the suspension of specie payments in January, 1862, throughout the war.[2] There were no non-monetary factors adequate to explain the rise in prices; no large increase in demand and no shortage of supply. The war did not begin precipitously, nor was it at first prosecuted vigorously. Business depression offset the stimulus of government buying. Nor was this situation essentially changed as the war progressed. Had the premium on gold reflected anything other than the depreciation of the paper money, imports would have increased and exports decreased, but such was not noticeably the case. Prices in the countries of closest trade relations, such as England and Germany, would have felt the influence of real price increases in the United States, but their price levels were practically the same in 1865 as they were in 1860. Greenback prices in the United States increased 109% between 1860 and 1865, while prices in England increased only 5.8% and only 1.4% in Germany.[3] It seems clear that had there been no dilution of the currency, Civil War prices would have risen little or not at all.

(c) *Prices during the Great War Due Primarily to Economic Causes*

In the Great War, however, general economic as well as monetary factors determined prices, and prices would have risen even had there been no inflation properly so-called. It is of course difficult clearly to distinguish between general economic and monetary influences, for rising prices would

[1] Wesley C. Mitchell, *History of the Greenbacks*, p. 276 *et seq.*

[2] *Ibid.*, pp. 423-4.

[3] *Ibid.*, p. 273.

be possible even under the operation of the most perfect banking system ever devised if demand were enhanced or supply curtailed. The European War was an enterprise of destruction on the largest scale ever known. It at once drew from productive activity millions of men to effect this destruction. Moreover, private demand could not be curtailed to counterbalance fully the increased public demand, and citizens competed with their governments for diminishing supplies of goods. Production was speeded up, and women were more extensively employed in industry, but supply could not satisfy demand. Were it possible to isolate these economic factors, the exact effect on prices of currency policy and inflation could be determined. It is very doubtful, however, whether any statistical measurement of the factors can be made. When depreciation takes place in one country only, as it did during the Civil War, it may be measured by the premium on gold or by the exchange rates, but when inflation is general, as it was during the Great War, the value of gold itself is affected. In the latter case the free gold market disappeared and gold shipments were subject to close government control, even in the United States. American prices were on a parity with gold, but they rose to high levels. Commodity scarcity to a large degree explains this lessening of the purchasing power of gold, but there was undoubtedly a shift in the equation of exchange from the standpoint of gold itself. The widespread abandonment of gold as a money instrument, and its transference in large volume to America—where it was hoarded—have had an inherently depressing effect on its exchange value. With little world demand for it as money, and a supply in the United States far in excess of demand here, gold has been to a degree demonetized in the United States itself.. It is for this reason unlikely that pre-war world prices will again prevail until the world use and demand for gold as money is again as widespread as in 1913.

With a rise in world prices due to factors universal in their scope, it would be possible to appraise the influence of currency policy on British prices only by fully discounting those factors which would in any case have raised prices even had there been no inflation in the proper sense. The method used by Professor Mitchell in studying Civil War inflation, of comparison with index numbers in other countries, cannot be employed here because of the impossibility of getting any index which has not itself been subject to inflationist influences. An index of American prices would be the best basis for such a comparison, because American prices were on an apparent parity with gold, but clearly there was considerable inflation in the United States itself, through the creation of Federal Reserve credit to finance war loans. The parity of American prices with gold has not the significance that it would seem at first sight to have. Early in the war gold was shaken off, not only as a means of control over international prices but also as an accurate measure of their relations.

The worldwide abandonment of the gold standard brought about an era of "managed currencies" which extended even to the United States. By mutual arrangement the exchanges were "pegged." In fact, the "pegging" of sterling exchange in New York was a sweeping device to control the price of goods purchased by Great Britain in the United States. By centralizing purchasing and by a system of allocating contracts to American manufacturers established early in the war, and by the more comprehensive international price controls established after our entry into the war, along with the strict licensing of imports and exports maintained throughout the trading world, free competition and the free flow of goods were as much restricted as the flow of gold. America was at first only a neutral, then later a partner in the war; at first primarily a seller, then herself

a large user of war supplies. Credits were advanced by the American government quite independently of those normal forces which check and control international capital movements, in order to facilitate European buying. Goods shipped to Europe carried a high price differential because of war-hazard freights and insurance. The free flow of commodities and gold under competitive conditions, for profit, which ordinarily regulates international prices, was absent in the period under consideration.

With this fully understood, and the limitations of such comparisons kept in mind, it will be of interest to study comparable indices of wholesale prices during the war period in Great Britain and the United States. Such indices have been carefully prepared by Professor Mitchell [1] for the War Industries Board. He has compiled a table of the medians of relative prices of identical lists of 150 commodities, with July, 1913 to June, 1914 as a basis. The graph given on page 166 [2] was constructed by him from this table. This graph shows that prices in the United States and in Great Britain were almost the same in April, 1917, when the United States entered the war. If it were assumed that American prices, being on a parity with gold, were not inflated, then it would be correct to say that British prices in April, 1917 were only a slight degree above gold parity and hence only to a slight degree inflated. This is manifestly absurd. The graph shows only the extent and relation of inflation in both countries, and that at the end of 1918 British prices were about 18% more inflated than American. This demonstrates the contention made above that so-called gold prices were inflated prices only to a less degree than paper money prices. It is at once clear that there were powerful economic forces determining prices in Great Brit-

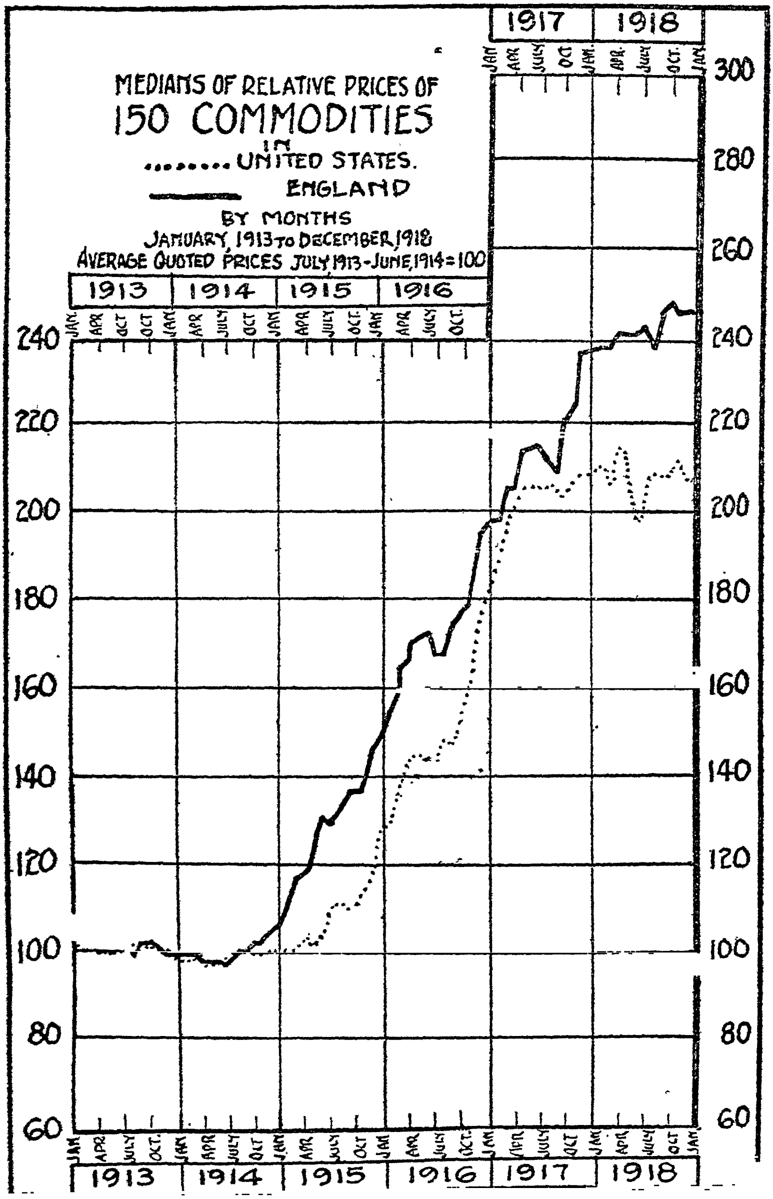
[1] Wesley C. Mitchell, *International Price Comparisons*, p. 18.

[2] *Ibid.*, p. 21.

ain and equally clear that the measurement of these forces is almost if not entirely impossible. Inflation in Great Britain had its counterpart in America despite gold parity. American inflation, as well as British, was caused to a large degree by the abandonment of sound banking practice and fiscal policy, which the stress of war explains but does not justify.

It may be contended that the graph merely shows price levels, and that these may be explained adequately on the ground of world scarcity. It has been demonstrated, however, that inflation of credit took place in both countries through machinery set up for that purpose. This is particularly true of Great Britain. American inflation was less extensive, for it was limited to deposit expansion in connection with loan drives. The British device, as has been pointed out, was at the center of the whole financial structure and functioned to make credit creation rapidly cumulative and practically automatic. We know that there were economic as well as monetary influences affecting prices, but unfortunately we can measure neither.

The graph shows an interesting contrast in the trend of the price levels after America entered the war in April, 1917. American prices closely followed the curve of British prices up to that time, and both price levels were practically the same when the United States began active participation in the struggle. Thereafter, British prices continued to rise, but American prices, although they fluctuated somewhat, at the end of 1918 stood at the same level as in April, 1917. Is the explanation of this that American price controls were more effective than British, or does the answer lie in the peculiar character of the British machinery, which made inflation hard to check once it had acquired momentum? Possibly the intensification of the submarine campaign, with the losses it entailed, and the consequent higher prices for


MEDIANS OF RELATIVE PRICES OF
150 COMMODITIES
IN
.... UNITED STATES.
ENGLAND
BY MONTHS
JANUARY, 1913 TO DECEMBER, 1918
AVERAGE QUOTED PRICES JULY 1913-JUNE, 1914=100
1913
1914
1915
1916
1917
1918
JAN
APR
JULY
OCT
300
280
260
240
220
200
180
160
140
120
100
80
60

goods laid down in Great Britain as compared with the prices of the same goods in the United States, is an adequate explanation of the divergence. Speculation on the subject demonstrates the difficulty of arriving at any very definite conclusions in regard to international prices during this period, in view of the complexities of controls and agreements between countries which the war brought about.

CHAPTER IV

THE BANK OF ENGLAND

THE Bank of England, as the central credit institution of Great Britain, played the leading role during the critical period of war finance. The function of the Bank in the various financial mobilization schemes has been discussed in Chapter I. This function was, briefly, to rehabilitate the bill market and to restore confidence abroad by an arrangement to discount all approved bills accepted before August 4, 1914, under government guarantee against loss and without recourse to the holders. Acceptors were afforded the facility of deferring payment indefinitely by paying interest at 2% above bank rate varying. This gave the opportunity for delayed remittances to arrive from abroad. Furthermore, arrangements were made to put acceptors in funds where required to meet premoratorium bills, for a period running, if necessary, until one year after the war, and also to cooperate with the joint-stock banks in supplying funds to acceptors of bills drawn after the moratorium, where the funds were not forthcoming from abroad.

These aids to the money market did much to restore the confidence of the banks and financial institutions and to bring about their normal functioning, especially in the interval of credit stringency which existed before the currency notes relieved the strain. In this also the Bank played an important role, as the mechanism for emergency currency issue and management was set up in the Bank. Ways and Means Advances came to be, through the compliance of the Bank, a facility for unlimited overdraft by the government. As has been explained in the third chapter, the extensive use of these overdrafts was made possible by the

legal-tender character of the treasury notes, which went into circulation as "advances", to banks and institutions, and served as "cash" reserves on the basis of which credit was built up. The loans and deposits, especially of the "Big Five", were thus capable of almost unlimited expansion. The Bank of England, in order to have "funds" for government overdrafts, then borrowed directly from the banks at fixed rates of interest. This practise of the Bank of England borrowing from the banks was an entirely new departure and was followed only during the period when the government needed unlimited credit accommodation, namely, from the beginning of 1916 to the end of July, 1919. These borrowings by the Bank, as previously pointed out, were credited to the government's account as Ways and Means Advances and were checked against by the government, in due course reached the banks again, swelled their deposits and gave them still further "surpluses" to loan to the Bank. The Bank was thus the government's principal agency for credit creation and its channel for currency dilution as credit expansion made necessary increased circulating media and increased bank "reserves."

The Bank likewise played an important part in the flotation of the war loans. The pressure for funds caused by the large periodic loans forced the banks to withdraw their advances to the Bank of England for a time, and to seek a certain amount of accommodation from the Bank to support their large advances to the public on the war bonds. This direct borrowing from the Bank was likewise quite contrary to normal practise. Ordinarily, in times of stringency the joint-stock banks secured funds from the Bank only indirectly, by withdrawing their accommodation to short-loan borrowers and forcing *them* to go to the Bank. The purpose of the war-time arrangement was to insure the success of the war-loan drives. The Bank did not at any time except for

a brief period before currency notes were available use the authorization given under the Currency and Bank Notes Act to increase its fiduciary issue of notes. The relatively large increase which did take place had full gold backing.

A complete picture of the Bank's functioning during the war can best be secured by a careful study of the prewar organization of the Bank and its normal relation to the money market, in comparison with its organization and practices as altered to make more effective the Bank's aid to the government in financing the vast war operations. These operations were reflected in the statistical statements of the Bank's situation during the war. In the opinion of certain bankers, the war emergency demonstrated the advisability of permanent changes in the organization and operation of the Bank of England, and the proposals of these bankers are discussed in the present chapter.

I. THE ORGANISATION OF THE BANK OF ENGLAND

THE present organisation of the Bank of England dates from the Bank Act of 1844.[1] That Act was part of a general plan having as its purpose the regulation of the note circulation by laying down the general principle that with the exception of a predetermined amount, all future issues of notes should be in the hands of the Bank of England, and that the latter, with the exception of an amount of £14,000,000, which could only be increased if the other note-issuing banks gave up their issue, when the Bank could take up a maximum of two-thirds of the amount against securities,[2] should be issuable only against the holding of bullion or coin [3] in the vaults of the Bank. This was the celebrated

[1] 7 and 8 Vict. cap. 32.

[2] Sec. V of Act.

[3] By Sec. III of the Act the Bank might hold silver in the issue department up to an amount not exceeding 25% of the gold coin and bullion held in the Issue Department.

currency principle of the reformers of the early 19th century. Legally the Bank was prohibited from increasing its note circulation without a corresponding increase in the volume of bullion held. The full effect of this provision was not at the time perceived. Since it definitely limited the note circulation, it greatly reduced the elasticity of that circulation, and consequently gave a great impetus to the formation of joint-stock banks, granting loans not in the shape of notes, but in the shape of deposit credits. At the same time the Bank of England note became to all intents and purposes a gold certificate in normal times, freely exchangeable into gold on demand. Likewise the note was legal tender, and therefore sought for in times of monetary pressure apart from its metallic connection altogether, for what is required in the event of a financial crisis is not so much gold (though a drain of gold may occur as part of such a crisis), but a form of currency in which people have confidence and which is full discharge for a debt. Hence it invariably happens in times of financial difficulty that the free stock of notes possessed by the Bank tends to decrease through a drain on the reserve; or what comes to the same thing, the liabilities against the reserve increase by borrowing from the Bank—a point which will be investigated at further length in a later section.

The best method of studying the organisation of the Bank is to examine for a moment the weekly statistical return which it issues. This is known as the "Bank Return" and is a guide—in fact the only guide existent—to alterations in the business of the Bank from week to week. In essence the Return shows two points; the business of the Issue Department and the business of the Banking Department. For the purpose of understanding the underlying situation, a simplified form of the Return is here given:—

Issue Department

Notes issued:—	Securities
	Gold coin and bullion.

Banking Department

Capital and Reserves	Securities
Deposits and 7-day Bills	Cash (i. e. Notes and Coin)

The Bank Act of 1844 draws a rigid line of separation between the Issue Department and the Banking Department: to all intents and purposes therefore, the Issue Department deals with the Banking Department as it would with any outside person. Notes can only be given to the Banking Department in return for gold. In fact, the Banking Department obtains notes by buying gold from mining companies in return for a credit in its books,[1] handing over the gold to the Issue Department and receiving notes in return. But the withdrawal of notes from the Banking Department does not increase the total of notes issued by the Issue Department. Assuming then a large drain of notes from the Banking Department, does this result in a *decrease* of notes in the Issue Department? Only if the notes so drawn out are presented to the Issue Department *for conversion. In that case,* notes issued, notes in the Banking Department, and gold coin and bullion in the Issue Department *all decline:* but that is because the Issue Department has now cancelled

[1] The Act by Sec. IV says that "all persons shall be entitled to demand from the Issue Department of the Bank of England notes in exchange for gold bullion at the rate of Three Pounds, Seventeen Shillings and Ninepence per ounce of standard gold: (i. e. 11/12ths fine): Provided always that the said Governor and Company shall in all cases be entitled to require such gold bullion to be melted and assayed by persons approved by the said Governor and Company, at the expense of the parties tendering such gold bullion." The method described in the text is simply a difference in form and not of intent; for the gold is transferred to the Issue Department in return for notes transferred to the Banking Department. When there is strong market competition, the Bank will raise the rate somewhat above £3. 17. 9d. to attract gold or prevent re-sale.

notes by paying them in gold. If notes drawn from the Banking Department are *not* presented for conversion, but are simply hoarded, the only effect is to reduce the cash-balance of the Banking Department, and to weaken the ratio therefore of reserve to liabilities. Supposing this drain to continue indefinitely, what can be done in case the notes and cash in the Banking Department are at vanishing point? Legally the only thing that can be done is to raise the rate charged for accommodation, and thus to choke off further drains. But at a time of crisis, money at any price is better than no money at all. As a matter of fact it has happened on several occasions (the last of which was the outbreak of the European war) that the Government has been approached by the Bank and a request has been made by the Bank directorate that permission be given for an infringement of the terms of the Act of 1844—i. e. that notes in excess of the amount *legally* issuable against securities be issued, a promise of a parliamentary bill of indemnity being made by the Government as a warranty for the directorate so to act.

Between the passage of the Bank Act of 1844 and the outbreak of the European war in August 1914, the Bank Act had been suspended in this way in 1844, 1857 and 1866. It will be noted that these suspensions all occurred in the earlier period of the working of the Bank Act, and that it was not found necessary to suspend the Act during the sharp crisis of 1890. Nevertheless, the nominal rigidity of the Act and the practical difficulty of enforcing its operation should the crisis prove severe enough, has caused the Bank Act to be very severely criticised; and as will be seen subsequently, proposals for the alteration of the Act have come from the Committee on Currency and Foreign Exchanges itself. At this stage it is only necessary to point out that the rigidity of the note issue being given, it was necessary for the Bank to devise some other instrument for safe-

guarding itself. After the crisis of 1857, says Mr. Conant,[1] the Bank adopted the method of "raising the rate of interest rapidly by degrees of one per cent at a time, instead of fractions of one per cent, in order to arrest the export of gold." Such an elevation of the rate of discount of course also reacts on the home situation, for, by causing money to be dearer generally, it checks the dangerous conjunction of rising credit expansion and foreign gold exports. And it may be noted that this policy of discount-rate variations is again a matter upon which acute differences of opinion manifest themselves: there not being wanting a school which argues that this policy inflicts great loss upon English business men and represents a tax upon business in the United Kingdom which is wholly unjustifiable, in view of the alternative—a larger reserve and consequently a smaller necessity for abrupt variations in the rate. To this point also further reference will be required.

II. THE BANK OF ENGLAND'S RELATIONS TO THE MONEY MARKET

The importance which the notes in the Banking Department of the Bank acquire is due to the fact that the United Kingdom presents perhaps the most perfect existent example of the centralised reserve system. The entire banking transactions of the United Kingdom ultimately rest upon the store of notes in the Banking Department. For the joint-stock banks of the United Kingdom, although themselves possessed of certain reserves of gold, keep or rather (since the institution of the currency note has provided them with an alternative source of "cash") kept their main reserve in the shape of an account at the Bank of England. Any de-

[1] *History of Modern Banks of Issue*, 4th edition, pp. 129-30, and references there cited. On the crises of 1847, 1857, 1866 and 1890, and the historical aspects of the subject generally, see: Andréadès, "A History of the Bank of England," especially pp. 331-388.

mand for more legal tender then ultimately falls upon the Bank. At the outbreak of the war, the Bank was the only institution in the country possessing a stock of free legal tender—"free" in the sense that the amount on hand was greater, at any moment, than current demands at that moment.

Any strained condition, therefore, is felt at the Bank of England. And, under the pre-war working of the money market, such strain was felt through the action of the joint-stock banks. These withdrew their customary accommodation to day-to-day borrowers—primarily the bill-discounting houses. These, in default of being able to borrow elsewhere were forced to go to the Bank. The credits which they raised there they transferred to the joint-stock banks, who thus exchanged loans to the bill-broker for increased credits at the Bank of England. And, being forced to go to the Bank, bill discounters and others had perforce to pay the Bank rate of discount which thereupon became "effective". Hence any pressure on the joint-stock banks was finally transmitted through short-loan borrowers to the Bank of England, which, by raising the rate at which it would discount, checked, or tended to check, further demands for money.

Raising the discount rate was not, however, always effective. If the occasion for raising the rate was an adverse state of exchanges—a position not directly affecting the joint-stock banks—these latter might refuse to withdraw accommodation and thus the market, not needing to go to the Bank, would not be impeded in its operation. The great growth in the size of the individual joint-stock banks, their consequent greater funds and strength, made it in fact difficult for the Bank at times to enforce a policy intended for the ultimate good of the market as a whole. On such occasions the Bank was forced to extreme measures. It bor-

rowed from the joint-stock banks sums that it did not require in order to deprive the market of funds, drive up rates and thus force some of the brokers to have recourse to the Bank. It is understood that when the Bank borrowed in this way, the effect on the Bank's weekly returns was to reduce both the volume of its deposits and its holding of securities.

This point brings one to consider the Weekly Return in more detail. As an illustration the return dealing with the mid-July position in 1914 is given below:—

Bank of England

Weekly Account

An Account pursuant to the Act 7th and 8th Victoria,
cap. 32 for the week ended
Wednesday, July 15th, 1914

Issue Department

Notes issued	£56,908,235	Government debt	£11,015,100
		Other securities	7,434,900
		Gold coin and bullion ..	38,458,235
	£56,908,235		£56,908,235

Banking Department

Proprietors' Capital ...	£14,553,000	Government securities .	£11,005,126
Rest	3,431,484	Other securities	33,623,288
Public deposits	13,318,714	Notes	27,592,980
Other deposits	42,485,605	Gold and silver coin ...	1,596,419
Seven Day and other Bills	29,010		
	£73,817,813		£73,817,813

The first necessity is to introduce some technical explanation as to the meaning of the items; the next point will be to consider the relation of changes in these items absolutely and relatively to one another.

Remembering that the Issue Department is legally entirely separated from the Banking Department, the item "notes issued" means the *total* notes issued, whether held

by the Banking Department or by outside individuals or institutions. But since the Banking Department on the day in question held some £27.6 millions of notes, the "active" circulation, i. e. the notes in the hands of the public and other institutions amounted to £29.3 millions. It is a well known fact that of the amount of the active circulation, the greater part is in the hands of the banks, who hold it as till-money, so that the actual holding by individuals is relatively small. The uncovered note issue, or the fiduciary note issue, was £18,450,000, so that the proportion of gold to notes was 38/56 or about 68%, and since the fiduciary circulation is fixed, an increase in the note issue, increases the proportion of gold to notes issued.

Turning now to the Banking Department, the first item on the liabilities side are the Proprietor's Capital and the "Rest", i. e. undistributed profits. Next there come two items of the greatest importance: The public deposits and the other deposits.

The public deposits are the sums to the credit of Government held by the Bank of England at a given moment: hence one index to the financial position of the Government. Other deposits is the name given collectively to the accounts held at the Bank by private individuals, municipal corporations, joint-stock companies and includes, as probably the most important of all, the accounts of the joint-stock banks. The seven-day and other bills are small and unimportant items.[1]

Against these liabilities the Bank holds three groups of

[1] These are commonly known as "bank post bills", a form of draft issued by the Bank and drawn upon itself at 7 and 60 days' sight in exchange for cash. These bills were at one time used for making remittances by post, more especially to the Continent where they pass readily much in the same way as Bank of England notes. Of recent years the demand has greatly decreased ...": See National Monetary Commission: Interviews on the Banking and Currency systems of England, etc., 61st Cong., 2nd Sess., *Senate Doc. No. 405*, p. 19.

assets — government securities, other securities, and notes and gold and silver coin. The aggregate of notes and coin constitutes the "reserve", and the most significant single factor in the return is the "reserve ratio", i. e. the proportion which the cash reserve, so defined, bears to the active liabilities—the public and other deposits and the 7-day and other bills.

What is meant by a government security and what by "other security? When the National Monetary Commission interviewed the governor and directors of the Bank of England they were told that "government securities" included "all securities of the British Government or bearing the guaranty of the British Government, held by the Bank as investments and all temporary advances made to the British Government." The items comprised under "other securities" included discounted bills, collateral held against loans and all securities held as investments other than those described as government securities," though the Bank refused to disclose the composition of this item.[1] It was also explained that the Bank "does not purchase bills in the market"; that the Bank rarely did any discount business with the London clearing banks, but "does a large business from time to time with the colonial and foreign exchange banks, who are from the nature of their business always sellers of bills". The bills discounted had to bear two British names of which one must be the acceptor; that there was no minimum size; and that the maximum length of time to run was four months, exceptionally six. "The currency of bills accepted for discount is now from time to time

[1] 61st Cong., 2nd Sess., *Senate Doc., No. 405*, p. 19. The discounts amounted to £4,402,000 in 1875 out of a total of £19,163,000 of other securities, i. e. 23%. This is the last year for which the figure is available; the discounts had been falling off relatively almost from the beginning. For these historical details see annual tables in the Banking Almanac and "Bank Rate and the Money Market," by Sir R. H. Palgrave.

regulated by resolution of the court of directors, and varies constantly (within the limits so laid down) at the discretion of the governor, who is guided by existing condition of the market. As regards the class of bills accepted, no particular change has taken place of late years."

Figures relative to all these items are presented in Table I, taken from the "Banking Almanac", which is continuing the work inaugurated by Sir R. H. Palgrave. This table shows the development in the affairs of the Bank in recent years, before the outbreak of the war, which has, of course, greatly affected the items. This table shows:—

(1) That the proportion of notes in the hands of the public tended to decline slightly in the period under consideration, so that the additional notes issued all remained as reserve in the Banking Department. Likewise the proportion of notes issued against bullion tended to increase.

(2) The gold and silver in the Banking Department showed some slight tendency to decline in recent years.

(3) That the public deposits showed a distinct tendency to *increase*. This is easily explicable in view of increased government expenditure, which of course caused the average yearly balance to increase.

(4) Other deposits also showed a tendency to increase, but this tendency is by no means so marked as in the case of the public deposits. There is a rise from 1900 to 1901; a fall from 1907 to 1913. The year 1907 was a crisis year, and well illustrates the tendency for deposits at the Bank to increase in years of financial stress.

(5) Other securities also show some tendency to rise through the whole period.

(6) The last item to be discussed is the reserve. This also shows a tendency—though a slight one—to increase—especially between 1908 and 1911 but there was some falling off toward the end of the period.

TABLE I. BANK OF ENGLAND: ANNUAL AVERAGE OF TRANSACTIONS 1900–1913 AND PROPORTION OF THESE TRANSACTIONS TO 1844[1]
(1844 taken as = 100—Value in £ Million)

Year	Annual average of notes issued	Proportion to 1844	Active circulation	Proportion to 1844	Notes in banking department	Proportion to 1844	% Proportion of notes in Bk. Dpt. to total issued	% Notes issued against bullion	Gold and silver coin in Bk. Dpt.	Proportion to 1844	Total Banking Reserve	% Proportion to deposits and post. bills	Proportion to 1844	Public deposits	Proportion to 1844	Other deposits	Proportion to 1844	Other securities	Proportion to 1844
1900...	49.23	176	29.40	145	19.80	251	40	64	1.66	240	21.46	43	251	9.29	178	40.60	503	29.47	310
1901...	51.60	185	29.56	146	22.04	281	42	66	2.00	290	24.05	47	282	9.73	176	40.74	505	28.81	304
1902...	51.29	184	29.50	145	21.89	279	43	65	2.28	330	24.17	46	284	11.05	211	40.91	507	29.68	314
1903...	50.61	181	28.91	143	21.70	276	43	68	2.08	301	23.78	47	279	8.79	168	41.32	513	27.98	295
1904...	50.91	182	28.29	140	22.62	288	45	64	1.98	285	24.67	49	288	8.45	161	41.38	513	26.33	278
1905...	52.31	188	28.81	143	23.49	298	45	65	1.81	262	25.31	45	298	11.84	226	42.28	533	30.08	317
1906...	50.95	182	28.61	142	22.06	280	43	65	1.46	208	23.15	44	271	10.19	193	42.81	530	32.13	339
1907...	52.02	187	28.94	143	23.10	295	44	65	1.29	186	24.44	45	287	9.19	176	44.52	552	32.13	339
1908...	54.14	194	28.87	143	25.27	321	47	66	1.48	213	26.75	50	314	9.18	176	44.12	543	29.62	313
1909...	54.40	194	29.22	144	25.18	321	46	66	1.47	211	26.65	40	313	10.52	201	43.76	542	30.08	316
1910...	54.19	194	28.24	140	25.94	330	48	66	1.20	174	27.14	49	319	13.08	249	41.77	518	30.16	318
1911...	55.51	199	28.61	142	26.90	341	48	67	1.10	159	28.90	51	330	13.09	249	42.37	525	30.51	322
1912...	57.78	207	28.79	143	27.07	344	47	68	1.33	191	28.40	48	333	17.84	341	41.74	517	35.09	370
1913...	54.62	196	29.11	143	25.88	329	47	66	1.37	198	27.25	49	320	13.34	256	41.49	514	32.76	347

[1] From the Banking Almanac, London, 1919.

Since a high level of the reserve ratio tends to be accompanied by a low bank rate, and vice versa, it will be interesting to set out the two side by side over the period now under discussion.

Year	*No. of changes in rate*	*Average yearly rate*	*Reserve Ratio*
1900	6	3.975%	40
1901	6	3.715	42
1902	3	3.330	43
1903	3	3.750	43
1904	2	3.295	45
1905	3	3.004	45
1906	6	4.2625	43
1907	7	4.920	44
1908	6	3.015	47
1909	6	3.0125	46
1910	9	3.720	48
1911	4	3.465	48
1912	4	3.775	47
1913	2	4.770	47

It will now be in place to follow out some of the changes that may occur in the relative position of the items. From what has already been said, the somewhat summary reasons attached to the same will doubtless prove sufficient.

(1) Public deposits increase, other deposits decline. This change will occur whenever tax payments have to be made; the taxes increase the funds at the disposal of the government and reduce those at the disposal of the joint-stock banks.

(2) Public deposits decline, other deposits increase. This change will occur whenever heavy government disbursements take place, e. g. payment of dividends on funded debt.

(3) Simultaneous rise or fall in public deposits and public securities. A simultaneous rise will indicate that the government has been borrowing from the Bank; a simultaneous fall that these loans have been repaid.

(4) Other deposits and other securities,—a simultaneous rise and a simultaneous fall. The explanation is the same

as in (3) only this time it will be the market that is borrowing and repaying.

(5) Other deposits and other securities fall. This movement will occur whenever the Bank borrows from the market in order to make the Bank rate effective.

(6) Other deposits fall, reserve falls. This indicates that balances at the Bank are being drawn upon for the purpose of taking gold. If the gold is foreign shipment, this movement will be accompanied by a rise in bank rate.

(7) Other deposits rise, reserve rises. This indicates that gold is being returned from internal circulation through the banks; or from abroad, in consequence of a turn of the screw of the bank rate. If at the same time notes issued and gold bullion in the Issue Department increase, it may be taken as a sign of gold purchases by the Bank.

(8) Other deposits steady or rising, other securities rising, reserve falling. This indicates that the market is borrowing, repaying its loans to the joint-stock banks and these are drawing on the reserve for cash purposes.

(9) Notes issued rise, reserve rising. This indicates gold imports as already stated.

(10) Notes issued rise, notes in Banking Department steady or falling. This indicates that notes in the hands of the public are increasing.

It is fairly obvious from the above detail that the interpretation of the "bank return" is no easy task. Unfortunately, when the figures for the war period come to be discussed, it will be found that the complexity of the situation has not been lightened owing to the development of new relations between the market and the Bank, on which very little light has so far been shed officially.

The next question to be discussed is the Bank of England during the war period.

III. THE BANK OF ENGLAND DURING THE WAR PERIOD

(a) *Some changes in the practice and status of the Bank*

Some of the changes already touched upon in the course of the chapter upon financial mobilisation also fall logically within the scope of this section and require only a summary notice for the sake of completeness.

1. *Bank pays interest on bankers' deposits:* The Bank paid no interest upon deposits before the outbreak of the war. But, as has been pointed out, bankers' money at the Bank had been given since 1916 a rate of interest which varied between 3 and 4½, according to ownership (domestic or foreign banks). It was currently suspected at the time that this policy was in pursuance of an agreement with the government. In some published[1] correspondence relating to advances by the Bank to the government, the government speaks under date of January 5, 1918, of advances "at such rates of interest as from time to time be agreed, regard being had to the rates currently paid by the Bank in respect to their borrowing of foreign and domestic money respectively." This rather implies that the Bank was left free to decide rates for borrowed money itself, acting, therefore, as a "factor" rather than as pure agent.

2. *Joint-stock banks borrow direct from Bank:* The normal course of events before the war was that if the joint-stock banks desired to strengthen their position they drew funds from the short-loan borrowers and these were driven to the Bank for relief. The funds thus borrowed from the Bank were transferred to the original loaners who thus strengthened their hold upon the Bank reserve. It seems that during

[1] No. 176 of 1918. Copy of all applications made by the First Lord of the Treasury and the Chancellor of the Exchequer to the Governor and Deputy Governor of the Bank of England for advances to government authorized by Parliament from the 6th of January 1917 to the 5th of January 1918.

the war a more direct relationship was established. The joint-stock banks took advantage of the arrangements made as a result of the August 1914 crisis and discounted part of their holdings of bills at the Bank. Further, the arrangement by which holders of stock in the first 3½ per cent (November 1914) war loan were to be enabled to obtain loans against their holdings on very advantageous terms [1] gave an opportunity to the banks to borrow, even if they did not take advantage of it, since the banks subscribed largely to the Loan. It is known that during the period February-March 1917, when the payments on account of the great War Loan were disorganising the market to some extent, that the banks financed themselves during the period when heavy transfers were being made to government account by withdrawing their loans to the Bank "and by temporary borrowing to some extent from the Bank of England. The joint-stock banks were able to borrow from the Bank of England for 5 per cent for a month, or 5½ per cent for longer periods." [2]

3. *Opening of overseas branches and agencies:* (a) *Relations with Federal Reserve Bank of New York.* On May 3, 1917, the official announcement was made that

Negotiations for establishing relations between the Bank of England and the Federal Reserve Bank of New York, which were commenced by the Governors of the respective institutions some months ago, have now been concluded. The arrange-

[1] The *Statist* quotes in its number of May 15, 1915, p. 317, from the Chancellor of the Exchequer's speech that "For a period of rather more than three years, that is, from the date of issue of the Loan until March 1, 1918, the Bank of England will be prepared to make advances against a deposit of war stock or bonds, without collateral security, of amounts equal to the issue price of the stock or bonds deposited without margin at a rate of interest 1 per cent below the current Bank rate."

[2] Kirkaldy, Adam W., "Industry and Finance," p. 230.

ment provides that the Bank of England will act as the correspondent and agent in London of the Federal Reserve Bank of New York and that the Federal Reserve Bank of New York will act in a similar capacity in New York for the Bank of England. It is not the intent of the plan that these institutions engage in commercial foreign transactions, the relationship established being primarily for the purpose of affording greater stability to rates of exchange by maintaining with each other mutual accounts of deposit and by representing each other in the purchase of bills. The plan will also create machinery by which transactions in gold and gold coin will be facilitated, which should result, in normal times in eliminating or reducing the extensive and unnecessary shipments of gold between nations to settle international balances, which have heretofore not infrequently prevailed. The relationship will also establish a means by which it is hoped financing between the two countries can be accomplished in times of emergency without more strain upon the exchanges. Provision is made for participation by other federal reserve banks of the United States desiring to join in the transactions contemplated."

(b) As part of the policy associated with the payment of U. S. A. gold indebtedness to European financial centers and the formation of the New York gold pool "with a view to avoiding the still existent risks of ocean transit, the Bank of England established a branch at the Canadian Government Depository, Ottawa, agreeing to accept gold payments at that point as made in London.[1]

4. *Suspension of Bank Act:*[2] The controversy associated

[1] Noyes, A. D., *Financial Chapters of the War*, pp. 99-100.

[2] See *Economic Journal XXV*, p. 565 *et seq.* "The Bank of England and the suspension of the Bank Act at the outbreak of war," based in part upon a White Paper of 1915. It may be noted, as the *Journal* points out, that the Treasury letter only made a 10 per cent bank rate conditional on an *actual* excess issue, i. e. "There is nothing in the correspondence to show that the government required the bank rate to be raised to ten per cent, forthwith, or that the raising of the bank rate to ten per cent on August 1st, which has been made the subject of much criticism, was made a condition of the government letter.

with the conduct of the Bank during the acute crisis period immediately before the declaration of war, in raising the price of accommodation to 10 per cent has now only a historical importance. Two points are, however, of interest:—(a) Was the sanction to issue excess of notes given in the letter addressed to the Bank directorate on August 1, 1914, in response to a letter of the Bank's, by the Prime Minister and the Chancellor of the Exchequer ever acted upon? There is nothing in the Bank Return to show that it was, but Mr. Asquith, then Prime Minister, speaking in reply to a question in the House of Commons on November 9th, 1915, said that "The Authority of August 1st was never acted upon, and was superseded by Section 3 of the Currency and Bank Notes Act, 1914, which received the Royal Assent on Thursday, August 6th. On August 7th and 8th, as adequate supplies of currency notes were not for the moment available, certain notes of the Bank of England were used at the request of the Treasury for the purpose of advances to bankers under the Currency and Bank Notes Act, the maximum excess involved being £3,043,000. By August 10th the position as regards the bank notes had become normal in all respects." Bank returns were issued on August 5th and 12th, so that the position was never revealed to the public at all. Mr. Asquith states the position accurately so far as the legal basis of the excess issue was concerned, for since the excess issue took place on the 7th and 8th of August, the Currency and Bank Notes Act was already in force. (b) Section 3 of the Act has already been referred to in the first chapter. The salient point is that "The governor and company of the Bank of England and any persons concerned in the management of any Scottish or Irish bank of issue may, so far as temporarily authorised by the Treasury and subject to any conditions attached to that authority, issue notes in excess of any limit fixed by law."

This clause had no effect, at any rate so far as the Bank of England was concerned. Its practical importance lies in another direction. So long as clause 3 remains unrepealed, the Bank Act of 1844 is in effect amended, and the note issue of the Bank of England loses the element of complete inelasticity which formerly distinguished it. Instead of the German system of "excess issues" based upon the principle of a taxed issue, the British plan is to entrust authority to a government department. It may broadly be said, therefore, that so long as this clause remains unrepealed, the criticisms formerly passed on one aspect of the Bank Act no longer holds good. The wisdom of *permanently* retaining this provision has in fact been endorsed by the Committee on Currency and the Foreign Exchanges:[1] a point to which reference will again be made. During the whole war period the point has been of little importance for reasons fully stated below.

5. *The ultimate source of legal tender during the war ceased to be the Bank of England:* The reason for this statement has already been given in the chapter dealing with the currency note policy of the government. So long as bankers could buy Treasury notes "across the counter" at their face value there was no need to issue excess Bank of England notes under Treasury sanction. But so long as Treasury notes could be freely bought, the Bank ceased to be the ultimate source of legal tender. This conclusion is, in fact, completely recognized by the Committee on Currency and Foreign Exchanges, together with the important corollary that the Bank, through the existence of an "alternative source" of legal tender money, ceased to be the ultimate controlling authority in the money market. The whole of the currency note proposals of the Committee were nothing but an attempt at restoring this authority, by linking up the

[1] Cd. 9182, par. 33.

government note with the banking reserve in the interim period and by finally vesting the whole control over note issue in the hands of the Bank.

In a later section of this chapter the statistical aspects of the Bank situation during the war will be examined at some length. Here certain aspects of the Bank policy will be examined which will render that statistical examination more useful.

(b) *Some Aspects of the Bank Situation during the War*

(1) *The crisis period:* In the perilous days preceding the outbreak of war, the Bank fulfilled its traditional role of ultimate authority in the money market, the other deposits and other securities rose. This will be seen by taking the July figures and those for August returns.

	Other Deposits (millions)	*Other Securities (millions)*	*Reserve (millions)*
July 1	£54.5	£40.0	£29.7
8	43.8	49.7	28.5
15	42.5	34.8	29.2
22	42.2	33.6	29.3
29	54.4	47.3	26.9
Aug. 5	56.7	65.3	10.0
12	83.3	70.8	15.5
19	108.1	94.7	19.2
26	123.9	109.9	26.3

The figures for July 1st of the other deposits reflect the usual position at the end of the half year, when in consequence of the joint-stock banks recalling loans from the market for "window dressing" purposes, there tends to be recourse to the Bank for assistance. The figures then fall off until July 29 when there is a sharp rise both in other deposits and other securities. This rise is still sharper in other securities between July 29 and August 5; whilst coincidentally there is a great fall in the reserve. By the

end of August the reserve is almost normal again, but other deposits and other securities are greatly above their prewar normal figure. By that time, in fact, the government scheme [1] for relieving pressure in the discount market was already well under way. On August 12, 1914, the Government transmitted to the Bank a copy of a press notice which they proposed to issue on the 13th, at the same time conveying "the authority of His Majesty's Government to take action on their behalf in accordance with the scheme and an assurance that they will in due course ask Parliament to give statutory authority for the arrangement adopted, and for the charge against the Exchequer of any loss which may be incurred by the Bank as the result of their operations in the matter." [2] This scheme was the rediscount of approval prewar bills by the Bank. It was in due course followed by the scheme by which the Bank advanced money to acceptors to pay all approved prewar bills at maturity (Sept. 5, 1914, government press notice; Oct. 2, Bank of England notice) : and, at the end of October, of the scheme whereby the Bank of England would advance "to lenders to whom the scheme is applicable, 60 per cent of the value of the securities at present held by the lenders against any loans which they had outstanding on the 29th of July, 1914" in order to clear up the Stock Exchange situation.

[1] On the whole of the following see *Financial Edition of Manual of Emergency Legislation, V, Government Assistance to Credit and Business.*

[2] This assurance was carried out by the Government War Obligations Act 1914, which received the Royal Assent on November 27th, 1914. Section 1 of the schedules covers "guarantees given to the bank of England in connection with (a) The discount of bills of exchange; (b) Advances to acceptors of bills of exchange; (c) Advances in connection with loans made to members of the Stock Exchange." In addition to these schemes, a scheme was inaugurated early in November with regard to outstanding debts in foreign countries and the colonies, against which bankers were to advance up to 50 per cent of the amount outstanding. As this did not especially affect the Bank of England it is not alluded to in the text; the ultimate loss, if any, was to be borne to an extent of 75 per cent by the Exchequer.

The working of the scheme shows how marvellously elastic, for good or evil, the British system of deposit loans is. In effect, holders of bills under the first scheme, creditors under the second, lenders under the third obtained credits at the Bank, which were reflected in the rise of the other deposits and in corresponding rises in other securities. They therefore obtained the finest form of liquid currency they could possibly expect, though they were required to pay for it at some cost to themselves, since the Bank advances were made at 2% over Bank rate, varying (on stock exchange loans the rate was 1% above Bank rate with a minimum of 5 per cent.) The amounts advanced were stated by Mr. Lloyd George in the debate on the War Obligations Bill at £120,000,000 on prewar bills, and £60,386,000 to acceptors to meet their bills. An amount of £50,000,000 would remain in cold storage until the end of the war, of which amount a very considerable part would be Russian Bills.[1]

(2) *The Period of "Spectacular Loans:"* The subject of government financing is fully treated in the first chapter. Here it is only necessary to point to the effects which the policies adopted have had upon the Bank of England. Both Sir Drummond Fraser of the Manchester and Liverpool District Bank—the most important of the remaining provincial banks—and Professor H. S. Foxwell have particularly emphasized that "long dated spectacular loans on the consol principle" cause bank inflation. Professor Foxwell puts it tersely that "every big loan means a large expansion of bank deposits." Sir Drummond Fraser has very well shown by means of diagrams that in 1916, during which the principle of continuous borrowing was adopted, money prices and the figures of the Bank of Eng-

[1] For the whole debate in which personalities played some part see Hansard, *Commons*, vol. lxviii, p. 1545. The Bank advances to the Stock Exchange amounted to £520,059. *Ibid.*, vol. lxxi, p. 853.

land's return show remarkably little movement as compared to the movements of 1914 and 1915, during which time two big loans were financed (in addition to the credit movements involved in the government schemes for putting the discount market on its feet again).[1] The chart opposite page 190 shows the matter as plainly. The three "peaks" in the figures are with one exception associated with loan and credit policies already discussed. The exception is the December 1918 peak, which is associated with "end of the year movements".[2]

(3) *Ways and Means Advances:* There is one aspect of government borrowing from the Bank which aroused much comment during the war, partly because the amounts were large, partly because the position in regard to them was not always clearly understood. This is the form of advances known as Ways and Means Advances. The constitutional position is thus explained by Mr. Henry Higgs of the Treasury, who is also a well known economist:—"The Bank of England is prohibited by its Acts and Charters from lending to the government unless authorized to do so. Such an authority is always given by the Consolidated Fund Acts of each session, authorizing the Bank to advance on the applica-

[1] See Drummond-Fraser, "Continuous day-by-day borrowing" in *Labor, Finance and the War*, p. 321 *et seq.* and Foxwell, H. S., *Papers on Current Finances*, pp. 39-51 and 240-245. The same chart is given in both publications.

[2] The figures reached their highest point on July 1, 1919, when "other deposits" reached the enormous aggregate of £214,894,000. The *Economist* for January 5, 1919 points out "Instead of the bill brokers being driven into the Bank of England by calls of cash by the banks, the banks on this occasion were able to call in what they wanted out of their advances to the Bank of England. As there appears to have been some sort of an agreement not to show more than a certain proportion of cash in balance sheets and some of the banks found that they had taken back rather too much from the Bank of England, the paradoxical result was something like a plethora of credit seeking employment on the afternoon of New Year's Eve.

tion of the Treasury to the amount covered by the Act the sums required for the public service in respect of any supply granted in the same session. These are called Ways and Means Advances."[1]

As an instance of the limitations imposed by the annually recurring Supply Acts, the following section from the Appropriation Act, 1917, may be given:

(1) The Treasury may borrow from any person by the issue of Treasury bills or otherwise, and the Bank of England and the Bank of Ireland may advance to the Treasury on the credit of the said sums,[2] any sum or sums not exceeding in the whole five hundred and fifty million, four thousand four hundred and ninety-five pounds.

(2) The date of payment of any Treasury bills issued under this section shall be a date not later than the thirty-first day of March 1918 and Section Six of the Treasury Bills Act 1877 (40 and 41 Vict. c. 2) (which relates to the renewal of bills) shall not apply with respect to those bills.

(3) Any money borrowed otherwise than on Treasury bills shall be repaid, with interest not exceeding five pounds per cent per annum, out of the growing produce of the Consolidated Fund, at any period not later than the next succeeding quarter to that in which the money was borrowed.

(4) Any money borrowed under this section shall be placed to the credit of the account of the Exchequer, and shall form part of the said Consolidated Fund, and be available in any manner in which such Fund is available.

The really important section is three, from which it will be noted that the conditions of interest due and the time of repayment are both fixed by the Act. It appears from published correspondence that on one occasion at least the Bank had found it necessary to warn the government that it was

[1] *The Financial System of the United Kingdom*, p. 94.

[2] i. e. the sums voted by Parliament.

straining the resources of the Bank. In a letter dated July 5, 1917, the Bank said:

> We beg to inform you that your letter of the 4th inst. was laid before the Court of Directors at their meeting this day, and that after discussion the Court agreed to advance during the current quarter . . . such sums as may be required to carry on the public service; *but the Court desires us to call your attention to the amount which has already been advanced on the credit of Ways and Means, and to convey the expression of their hope that you will realize the inadvisability of an increase in these advances and their earnest desire that measures should be taken for repayment.*[1]

This recalls, almost in the same words, the famous series of remonstrances addressed to William Pitt by the Court of Directors during the Napoleonic wars, and well illustrates the dangers which a too close alliance between a central bank and the government of the day creates at a time of financial necessity, i. e. pure inflation by virtual fiat. These advances and that part of the public loans which was absorbed by the banks and not by the savings of the public, were merely credit created by the war powers of the Government. The currency notes were that and more. Not only did they represent credit creation to the amount of their issue, but in addition they made possible a pyramiding of bank credit on a large scale, for government use. In a word, these various devices were different methods of sugar-coating the same process of credit creation by parliamentary decree.

IV. THE INCREASE OF THE NOTE CIRCULATION OF THE BANK OF ENGLAND

It will be noticed if the chart opposite page 190 is studied that the note circulation of the Bank of England shows a re-

[1] Italics not in original.

markable expansion in the later period covered by the chart as compared to the earlier period. Between August 1914 and August 1917 the note circulation is almost stable; after the latter date there tends to be a rise which becomes more and more marked as the months pass. This is a tendency so completely opposed to the relative immobility of the note circulation alluded to previously that it merits a word of explanation. Two main causes can be distinguished.

(1) The first is the rise of prices. As prices rose, partly in consequence of inflation, partly of real shortage, due to war destruction and difficulties of production and distribution, it obviously became more convenient for individuals to carry about notes of larger denomination than the £1 or 10*s.* treasury note, for the number of these required tended to become inconveniently large. Part of the increase in the note circulation is therefore to be associated with the choice by the public of a more convenient form of currency.

(2) The second is the increased duty on the use of checks. Until 1918, the stamp duty on checks was 1*d.* for any amount over £2. By the Finance Act 1918, Part IV, Sec. 36, the stamp duty on checks was increased to 2*d.* The Chancellor of the Exchequer was at the time warned that this policy was a mistaken one, and that it would tend to increase the note circulation. The official attitude was that an increase in revenue was urgent and that in any case the effect on the use of checks and notes respectively was not anticipated to be very significant.

There is no doubt that other causes cooperated to produce this large increase in the circulation. It is said that in order to avoid payment of excess profits duty, dealers passed notes, i. e. "cash" in order to avoid the recording of deals. Possibly for the same reason, there was some hoarding of notes thus acquired. Luxurious expenditure probably also contributed to the increase. When all possible allowances have

been made on these grounds, however, the almost unanimous opinion that the increased check duty stimulated the increase in the note circulation, still requires to be taken seriously.

V. THE STATISTICAL ASPECT OF THE BANK SITUATION DURING THE WAR

The attempt to elucidate the course of events by a study of the weekly return of the Bank of England has been made more than ever difficult during the period of the war by changes in the customs of the Bank, and such papers as the *Economist* constantly repeated their warning against a too liberal construction of movements in the return. In order to facilitate an understanding of the following tables and the chart, it is well to remember:

(1) That borrowing from the Bank by the joint-stock banks or the market increases other deposits and other securities *directly;* that repayments reduce these items *directly*.

(2) That borrowing by the government increases public deposits and government securities directly; repayments to the Bank reduce these items directly.

(3) Borrowings by the Bank from the joint-stock banks *decrease* other deposits and other securities; repayments by the Bank increase other deposits and other securities.

(4) Increases in the coin and bullion in the Issue Department increases notes issued and *may* increase either the reserve or the notes in circulation.

(5) Government taxation reduces other deposits and increases public deposits and government spending reverses this order.

The main influences causing alterations in the figures of the Bank have already been touched upon in previous sections and to go over them again here would be unnecessary.

TABLE II. HIGHEST AND LOWEST FIGURES FOR SELECTED ITEMS

(Figures in £ millions)

Bank of England Return—1914–1919 (September)

Year	Note Circulation		Total Reserve		Public Deposits		Other Deposits		Public Securities		Other Securities	
	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest
1914	37.186	28.077	55.707	9.967	45.002	7.185	167.971	38.774	31.290	11.005	121.821	29.723
1915	35.876	31.505	54.558	34.443	177.636	23.808	157.883	84.023	53.156	14.810	192.175	92.910
1916	39.665	32.507	44.942	27.827	69.914	48.444	127.727	78.583	57.187	32.835	114.748	63.601
1917	45.943	37.824	36.585	30.429	120.859	40.055	226.469	116.388	212.396	24.003	196.029	35.727
1918	70.306	45.222	32.141	27.253	43.842	27.418	158.411	120.131	73.685	45.991	113.486	90.661
1919	81.126	60.698	30.236	25.036	30.727	17.881	214.895	89.157	136.945	19.552	121.759	77.623

Differences between Highest and Lowest Figure in each Year

Year	Note Circulation	Total Reserve	Public Deposits	Other Deposits	Public Securities	Other Securities
1914	9.109	45.740	37.817	129.197	20.185	92.098
1915	4.371	10.115	153.828	73.958	38.347	99.285
1916	7.168	17.115	21.470	49.144	24.352	51.147
1917	8.119	6.156	80.834	110.081	188.393	160.302
1918	25.084	4.888	16.424	38.280	27.694	22.825
1919	20.429	5.200	12.840	125.738	117.393	44.136

The tendency of the various movements can best be studied from Table II showing, "Highest and Lowest Figures". This table well illustrates the relative changes in the position of the note circulation and the reserve. The former shows a tendency for the fluctuations to increase; the latter a tendency for the fluctuations to diminish. The fluctuations in the public deposits were greater in 1915; those of the other deposits in 1914 (with very great fluctuations also in 1917 and 1919). Public securities fluctuated most in 1917 and 1919; other securities in 1915 and 1917. The high level associated with 1917 in nearly all these items is to be associated with the immense turnover, borrowings and disbursements connected with the Great War Loan of that year.

Taking the period as a whole, we may sum up as follows:—

(1) Coin and bullion in the Issue Department and notes in circulation were well above prewar level; banking reserve rather below; and proportion of reserve to banking liabilities much below prewar level.

(2) Public securities and public deposits had been much above prewar level, but in 1919 were declining again.

(3) Other deposits and other securities were still greatly above prewar level.

VI. THE FUTURE ORGANISATION AND STATUS OF THE BANK OF ENGLAND

Surveying the position of the Bank in 1919, what changes in its methods and procedure seemed desirable to the critics of the Bank? Three lines of discussion require to be treated, which may be stated thus:—

(1) Demands for the amalgamation of the Banking and Issue Departments.

(2) Demands for the increase in the Fiduciary circulation.

(3) Demands concerning a strengthening of the reserve and a consequent stability in the Bank rate.

These subjects will be treated in turn.

(a) *The amalgamation of the departments*

Among the leading supporters of the proposal to amalgamate the two departments of the Bank was the late Sir Edward Holden. His main argument in support of the proposal was that the fluctuations in the Bank rate were distinctly unfavorable to the commercial community; that the amalgamation of the two departments would increase the ratio of reserve to liabilities and would therefore reduce the number of occasions upon which a change in the Bank rate would be deemed necessary. Before dealing with his argument at length, it may be presumed that the amalgamation of the two departments would not necessarily imply any change in the basis of the note issue. Notes issued could still be backed to their full extent by gold, but instead of the gold behind the note being kept apart in a separate establishment it would be kept together with the coin now in the Banking Department, which would no longer keep notes as a reserve but only as a form of till money, and which would, of course, not appear in the return except in the total on the liabilities side.

The position can be summarized thus (the figures are purely illustrative) :—

Issue Department

Notes issued	£150	Fiduciary	£18.5	Ratio of gold to notes, 87.6%
		Gold coin and bullion	131.5	
	£150		£150.0	

Banking Department

Public Deposits	£50	Securities	£85	Ratio of reserve to banking liabilities ..32%
Other Deposits	£75	Notes	39	
		Coin	1	
	£125		£125	

The change would work out thus:

Deposits	£125	Securities	£103.5	Ratio of reserve to total liabilites 55.1%
Notes held by public..	111	Coin and bullion	132.5	do. to deposits ..109 %
	£236		£236	do. to notes....119.3%

Sir Edward Holden, in his statement at the Annual General Meeting of his bank on January 29, 1918 worked out an example on the basis of the figures in the bank return for January 16, 1918, and came to the following conclusion:

We see that the reconstructed balance sheet shows a ratio of gold to notes of 129.7 per cent against 75.7 per cent under Peel's Act (i. e. the Act of 1844) or an increase of 54 per cent, and that the ratio of the cash balance to liabilities under the reconstructed balance sheet is 33.5 per cent against 19.6 per cent under Peel's Act, or an improvement of 13.9 per cent.

In 1919 he again, on the same occasion, recurred to the subject and presenting data based upon the return of December 19, 1918, said:

If the two departments of the Bank be amalgamated and the reserve fall, the rate can be put up in the same way as under the present system. There is no reason why the reserve should not respond to an increase in the rate in the same way as it does under the present system, but in the one case the reserve is not so small and consequently there would be no need for the same number of variations in the rate. As I have said, the smallness of the reserve in the Banking Department is responsible for its sensitiveness, and may compel the raising of the rate under conditions which do not really call for drastice measures. A careful consideration of the working of the Bank under both systems of presenting the accounts has convinced me that the position of the Bank is weakened by having two departments, that the raising of the rate, when such a step is necessary, will be just as effective under the amalgamated system as under the old and that fluctuations in the rate would be fewer in number and less severe. The old system offers no advantages which do not apply equally in the case of the new system, but by adopting the latter we should strengthen the position of the Bank and avoid those fluctuations in the Bank rate which must have proved injurious to our industries.[1]

[1] *Economist*, February 2, 1919, p. 146.

If so simple a matter as amalgamating the departments could produce all these desirable effects, it would indeed be folly to continue to adhere to the older system. In fact, of course, the whole of the position assumed by Sir Edward Holden is fallacious. As the *Economist* put it in commenting on the speech, "By reorganising the form in which the Bank's position is presented, we should not alter by one pennyworth its real liabilities and assets. It would be a different picture of exactly the same fabric, and because it looked rather prettier from the new angle of vision, the duty of those responsible for seeing that it was water tight would not be made one whit easier, nor would measures for keeping it so be any the less necessary." What are the "real liabilities and assets" of the Bank? The real liabilities are those on account of outsiders, i. e. depositors and note holders, its real assets, its securities and its gold. The sum of these items has not been affected by the change and consequently, so far as the outside public as a whole are concerned, the position of the Bank is neither better nor worse than it was. What has happened is that Sir Edward Holden has committed the fallacy of composition—has argued that what is true of two things separately will also be true of both of them taken together. Because, by amalgamating the departments, to use the illustration in the text, the position of the *outside* note holder is somewhat improved (from £131.5 of coin being increased to £132.5 by the addition of the £1 million coin in the former Banking Department), and because the position of the depositor by himself is also apparently improved (owing to the total holding of gold being put into the new department), the assumption is that the position of *both together* has improved. But this is not so. Before the change, on the assumption that all outsiders cashed their notes, there would have remained against the deposits £20.5 millions of gold in the Issue Department and

£1 million in the Banking Department. After the change, if all the outside holders of notes came on the Bank in a run, there would remain gold to the extent of £21.5 millions against liabilities, or exactly the same amount as before.

One of the strongest arguments for the separation of the two departments, however, is that under stress the Banking Department first feels the pressure and can take corrective steps by raising the rate, leaving the Issue Department as an untouched store of future ammunition. The note and the deposit are not put on a par as to convertibility into gold. This gives the note an entrenched position and affords the reserve a protection which otherwise it would not have.

The Committee on Currency and Foreign Exchanges did not concern themselves, except indirectly, with these numerical considerations. They disposed of the matter in a very summary paragraph (27 of the Report):

First, the main effect of the amalgamation of the two departments of the Bank of England would be to place deposits with the Bank of England in the same position as regards convertibility into gold as is now held by the note. It has been argued in favor of this change that greater security would be given to the deposits than under the present system. After careful consideration we are unable to recommend it. The deposits have at present the full security of the reserve in the Banking Department and it is obvious that any such additional security would be at the direct expense of the security of the note. In our opinion it is desirable that the issue of currency shall be subject to strict legal regulation but that the management of banking should be left as free as possible from state interference. We think that the amalgamation of the two departments would inevitably lead in the end to state control of the creation of banking credit generally, a contingency which we are convinced would greatly hamper the elasticity and efficiency with which the banks are able to meet the requirements of industry.

This is, in fact, equivalent to saying two things (1) that so long as note issue is to be subject to specific regulations, wherever the reserve is kept, an increase in the notes issued or a withdrawal of gold or both will lead to exactly the same results as at present: (2) to mix notes and deposits will lead to the deposit currency being controlled as well as the note issue, because an unlimited increase in the former will imperil the position of the latter, whereas at present this is not the case. If this is clearly grasped by the British banking world, the demand for the unification of the two departments will lose what hold it has. The real point lies rather in the demand, sometimes consciously, sometimes unconsciously, associated with the demand so far analyzed, that the *basis* of the note issue should be changed.

This is the next point which requires attention.

(b) *Demand for an increase in the fiduciary circulation*

The British habit of discussing the uncovered note issue as a fixed amount, a habit due to the Bank Act of 1844, leads to some confusion here. What is in fact required is a threefold analysis:—

(1) Should the normal amount of the fiduciary circulation be increased, but its total remain fixed?

(2) Should the normal fiduciary circulation be a fluctuating one?

(3) Should any increase in the fiduciary circulation be allowed only under exceptional conditions, i. e. should the principle of the Bank Act of 1844 normally be operative?

(1) The first of these questions requires to be answered because of the existence of the large fiduciary issue of Treasury £1 and 10*s*. notes. Are these to be retired or are they to be continued? As has already been pointed out in the section on the currency note, the proposal made by the Cunliffe Committee was that no further issues should take

place unless covered by the Bank of England notes, and that at some date in the future the whole of the note issue should be taken over by the Bank. The aim was to stabilise the *total* fiduciary issue at an amount consistent with the maintenance of a central gold reserve of £150,000,000, i. e. including the present Bank fiduciary issue of £18,450,000.

(2) Discussion, however, has been almost exclusively confined to the second point. The principle of a fluctuating fiduciary issue has been envisaged as transferring to the United Kingdom note issue the element of elasticity formerly wanting to it. The favored figure is 33-1/3% backing of gold, the remainder being issued against bills.[1] To this proposal the Currency Committee object on two grounds; the minor one being that the figure actually proposed is too low —" wholly inadequate " as they say (par. 28); the major objection being that " if, as happened in general in the German Reichsbank, other regulations keep the actual note issue much below the maximum fixed by this proportion, the proportion is not effective and produces no result. But, if the actual note issue is really controlled by the proportion, the arrangement is liable to bring about very violent disturbances. Suppose, for example, that the proportion of gold to notes is actually fixed at one-third and is operative. Then, if the withdrawal of gold for export reduces the proportion below the prescribed limit, it is necessary to withdraw notes in the ratio of three to one. Any approach to the conditions under which the restrictions would become actually operative would thus be likely to cause even greater apprehensions than the limitations of the Act of 1844."

(3) The Committee, as already pointed out, did *not* subscribe without amendment to the Act of 1844. Instead

[1] e. g. Sir E. Holden's 1918 speech, at the Annual Meeting; the Report of the London Chamber of Commerce (quoted par. 28 of the Cunliffe Report).

of adopting the suggestion that emergency issues should be allowed on the basis of taxing the excess, they proposed the continuance of section 3 of the Currency and Bank Notes Act, 1914, the reason given for the rejection of the alternative plan being that unless it (i. e. the tax) is fixed at a sufficiently penal rate to insure that the normal fiduciary issue is not exceeded except in circumstances of real emergency, and then only for a strictly limited period, the system may afford dangerous possibilities of excessive speculation and lend itself to the development of crises which more stringent safeguards might have averted altogether.

(c) *The gold reserve*

The Cunliffe Committee explain that the reason why they have in principle rejected the views outlined above, "in view of the comparison with the systems prevailing in foreign countries which have been put forward by various witnesses" is "that these countries have not in practice maintained the absolutely free gold market which this country, by reason of the vital importance of its position in international finance, is bound to do. It has therefore been open to them to have recourse to devices to steady the rate of discount, which, even if successful for this purpose, it would be inexpedient and dangerous for us to attempt." This raises the whole issue of the future of British banking reserve, on which a word may be said.

The "gold reserve question" is indeed no new one. Professor Foxwell, reviewing the position just after the outbreak of war,[1] caustically remarked that

> The appeals made in the last twenty years by such men as our author, the late Viscount Goschen, Sir Inglis Palgrave, Sir Felix Schuster, Sir Edward Holden, the late Mr. Spencer Phillips,

[1] Preface to the late Mr. George H. Pownall's *English Banking*; London, 1914, p. xiii.

Mr. Grammond and others, had been made in vain. Received in some quarters with cynical indifference, they never obtained more than a lukewarm, platonic assent. So far as published figures go, no appreciable result is traceable. Other nations, on the average, roughly doubled their reserve; we were content to talk about it. Hence the crisis found us, in spite of our quite exceptional international responsibilities as the world's clearing house, with a smaller proportionate reserve than any other of the great commercial countries. . . .

Professor Foxwell, himself a strong believer in increased reserves,[1] is perhaps a somewhat biassed witness, but he can certainly adduce an imposing row of witnesses. The conventional line of defence is to urge that other nations with greater reserves than the British found themselves faced with as great difficulties as a result of the European crisis; and in fact the "pull" exercised by the British financial power on debtor nations was so great that an external drain of gold was proved to be a pure nightmare. The danger was all the other way; withdrawal of facilities by the United Kingdom temporarily broke up the exchange market. No case has been made out for the contention that a large reserve would not have resulted in virtually the same situation. The answer perhaps is that a large reserve would not have depleted the store at the Bank so rapidly and that, as Professor Foxwell says, "We might have been spared the 10 per cent rate, than which nothing is more calculated to cause wreckage and provoke panic."

Assuming an increased reserve to be desirable, where should it be held and what should its amount be? As stated, the Cunliffe Committee desires to see a reserve of at least £150,000,000 "maintained concurrently with a satisfactory

[1] See in particular his paper on "The Banking Reserve" reprinted in *Papers on Current Finance*, 1919, pp. 135-170. In this paper Professor Foxwell rather inclines to the creation of "Secondary Reserves."

foreign exchange position." This still leaves the question open as to how this amount is to be obtained. The Committee recommended the transference to the Bank of England of the £28,500,000 held against the currency notes and further " in view of the withdrawal of gold from circulation, it is, we think, desirable that the gold reserves of the country should be held by one central institution and we recommend therefore that all banks should transfer any gold now held by them to the Bank of England, except such small amounts as they may require to keep for the convenience of travelers." The Committee thus support the principle of a single reserve.

To this Sir Edward Holden[1] strenuously objected, on the ground that " If this were done, the position of our joint-stock banks would be weakened in the eyes of the public and foreign banks. It is our duty to provide our depositors of the joint-stock banks the best reserve a bank can hold." His own preference was for " three reserves of gold; one reserve in the Bank of England, another held against the currency note, and a third reserve in the vaults of the joint-stock banks. The gold reserve against the currency notes might be used to strengthen the foreign exchanges when required. The gold which is held by the joint-stock banks, in addition to being a security for their deposits, might be used for a similar purpose, thus giving us three reserves acting as one reserve for the protection of the exchanges. I feel satisfied that this plan has only to be tried to prove successful."

It is difficult to see what " the plan " really is. If there are to be three reserves, who shall decide when the secondary reserves are to be called on to assist in restoring the exchange position? If these reserves *are* to be used for this purpose, what becomes of the depositors and the note holders? Sir Edward Holden tried in fact " to have his cake and eat it."

[1] *Economist Report*, February 1, 1919, p. 147, col. 1.

There is not the slightest doubt that occasions arise when the interests of particular institutions must give way to those of the market as a whole, and no better way has yet been discovered of achieving this end than the vesting of control over the reserve in the hands of a single authority.

The maintenance of the reserve would of course require the restoration of the right to manipulate the Bank rate, and, once the habituation to the idea of cheap money which the war brought with it is broken down by the pressure of facts, there is no reason to suppose that the Bank will be unable on this ground to bring back gold from abroad. The real danger, as the Committee on Bank Amalgamation pointed out, lies in another direction—the rise of great institutions which might defy the authority of the Bank—a danger to which the *Economist* in its article of Feb. 1, 1919, on Sir Edward Holden's speech,[1] somewhat pointedly refers.

Though the Bank played a most vital rôle in British war finance, there is little evidence to this effect where one would expect to find it, namely, in the Weekly Returns. This lack of relationship between the returns and the vast operations which the Bank is known to have carried on has been referred to above, and has called forth frequent caustic comments from writers in British financial papers. Though many large operations could conceivably have been carried on *between* returns, it is not likely that they could have always escaped record by mere coincidence. It is quite clear that the government chose to make these operations a matter of secret arrangement with the Bank, and a student of British war finance must be content to make the best conjectures possible with limited data.

It is of course known that the Currency Note Account was managed by the Bank for the Treasury, and that the Bank made easy the securing of currency notes as required; bor-

[1] *Economist Report,* February 1, 1919, p. 147, col. 1.

rowed large sums directly from the joint-stock banks; made unprecedented advances to the Treasury in the form of unsecured overdrafts, undoubtedly acting in this matter merely as an agent of the Treasury; and, when necessary, loaned to the joint-stock banks to assist them in carrying war loans. On the showing of the Weekly Returns, however, there is no relation between the fluctuation of Ways and Means Advances and Government Securities.

The Bank, again undoubtedly acting for the Treasury, influenced the policy of the joint-stock banks in fixing low rates on general public deposits as a means of securing a firmer hold on the money market.

In a word, the Treasury completely supplanted the Bank as the source of legal tender and the regulator of credit. The Bank was merely the instrument of the Treasury. The central reserve banking system was in effect replaced for the period of the war by a government monopoly of banking and credit. Merely the form and outward appearance of the prewar system was maintained. The function performed by the joint-stock banks will be discussed in the next chapter, and it will be noted how completely they too came under Treasury control.

CHAPTER V

British Banking During the War

Banking in Great Britain before the war was mainly in the hands of a relatively few large joint-stock banks, the stimulus to whose organization and development came from the Bank Act of 1844.[1] This Act centered currency issue in the Bank of England, and the joint-stock banks perforce developed deposit banking on a large scale. At the outbreak of the war their size and prestige seriously challenged that of the Bank of England, and on occasion they defied the authority of the Bank in its control of the money market and the exchanges.

Their function in war finance was therefore in the nature of the case a most important one. They quickly felt the effect of the war on credit and the exchanges because of their large holdings of bills and other credit instruments. By calling in their advances to the discount houses and bill brokers they put pressure on the Bank of England and weakened its reserves. Some of the banks set a bad example to the public by hoarding gold and paying out instead Bank of England notes, which were promptly cashed at the Bank. The conjunction of these two things brought about the 10% Bank rate. The supplying of an unusual amount of legal tender was not the only emergency service rendered the joint-stock banks by the Bank of England. It also took off the hands of the banks acceptances upon which payment was not forthcoming, loaned them up to 60% on Stock Ex-

[1] 7 and 8 Vict. cap. 32.

change securities, and stood behind them in advances to post-moratorium acceptors. The Bank of England and the banks were thus united in a joint effort to bring the money market back to normal functioning. The joint-stock banks, further, with the backing of the Bank, agreed not to press for repayment or to require additional margin on loans made against collateral security until one year after the war.

Throughout the war the joint-stock banks financed industry, which was of course mainly war industry, with all the credit necessary, although the government itself did some direct financing of manufacturers. They also aided the Bank of England in supplying credit to the government by lending their surplus balances to the Bank for Treasury account, and bought Treasury bills on a large scale. In fact, the banks were the principal market for these bills, so important as a means of furnishing the Treasury with short-term funds between the war bond issues. As has been explained elsewhere, the banks, through the working of the government's own credit-creating machinery, had ample funds both to buy bills and to lend to the Bank.

As has been pointed out in Chapter III, the banks likewise bought heavily of the government's securities and extensively carried their clients in the purchase of these same securities, particularly in the later years of the war. The Bank of England was the Treasury's agency for credit creation, but this credit expanded primarily in the banks. Other Deposits at the Bank of England swelled at times to unprecedented volume, reaching on July 1, 1919, £215,000,000, but on the average were in the neighborhood of £100,000,000, which was only a fraction of the aggregate bank deposits of the country. Reference to the figures given on page 151 will show that deposits for the principal banks increased over a billion pounds between June 30, 1914 and June 30, 1919. This expansion, as is demonstrated in the

analysis of the tables at the end of the chapter, was mainly on government account. Reference to Table V on page 254 will show that from the end of 1913 to the end of 1918 Discounts and Advances, in which category Treasury bills were listed in most instances, increased from 683 million to 1025 million pounds and investments from 191 million to 520 million pounds. The percentage of Other Securities to Government Securities was 87% at the end of 1913 and 25% at the end of 1918. The segregation of Treasury Bills from other paper is not available, nor are we able to determine the extent to which Treasury bills were included by some of the banks in the category of investments. The large increase of Discounts and Advances, however, in view of the great reduction in the volume of trade paper due to the war, is a fairly accurate barometer of the amount of Treasury bills carried by the banks. This situation also finds reflection in the change in the ratio of Discounts to Advances for the United Kingdom as a whole. The ratio rose from 19% in 1913 to 60% in 1918, indicating the great absorption of bills in the credit accommodation of the banks. Advances were but slightly more in value at the end of the war than they were in the beginning. In fact, making allowance for inflated prices, they were considerably less—this despite the fact that in the latter part of the war large sums were advanced to clients to buy war bonds. With private business curtailed, as evidenced in these figures, we have another proof of the dominance of government finance in the greatly extended war-time operations of the banks.

It may be well to repeat here what has been said before, that loans always mean corresponding deposits. Taking the banking system as a whole, every debit meant a corresponding credit. Every extension of loan operations by the government, short-time or long, resulted in increased deposits. The large increase in bank deposits during the war reflected

government borrowing and nothing else. There were no actual increases in real assets or reserve properly so-called. In fact, the "cash" of the banks did not differentiate coin from currency notes, and the "cash at the Bank of England" could mean entirely or for the most part credits built up out of drafts drawn against government unsecured overdrafts at the Bank. A comparison of war-time bank figures with prewar figures means little except as a measure of inflation. This is true for all the items on the balance sheets. Even the capital increases at the beginning of 1919 were made with diluted money.

In this connection, the decrease in the ratio of aggregate capital to aggregate deposits, which reached about 5% at the end of the war as against 10% at the beginning, is not so serious as it might at first seem, because the necessary post-war contraction will correct this condition and restore at least the prewar ratio. When deflation has been completed, the capital increases which took place early in 1919 will tend to increase the ratio over what it was at the outbreak of the war.

The arrangements which the banks had for lending surplus balances to the Bank of England do not reflect themselves in the latter's statement, nor has the exact nature of these arrangements ever been disclosed. This lending of surpluses and the large-scale buying of war issues were the principal means used by the banks in rendering aid to the government in financing the war. They were well paid for their assistance, however, as they received interest on these surplus balances which were directly created by the government itself. The banks were a "war industry" and their profits were large, but it is not recorded that they paid Excess Profits taxes. The Bank of England, on the other hand, although a private institution, turned over to the Treasury after the armistice the total profits which it had received from war operations.

The large demands made on the banks in connection with war financing led directly to the notable increase in bank amalgamations which the war period witnessed. Probably a still more important influence in this regard was the realization of the need for greater banking strength in the inevitable after-war struggle with competing nations for the world's markets. Germany's rapid prewar development in industry and trade, and her war demonstration of highly perfected economic organization, had carried a lesson home to British leaders. Bank amalgamations were primarily part of a general movement to mobilize for post-war effort and to modify British method in banking and trade better to cope with the problems to come. A perusal of the report of the Committee on Financial Facilities for Trade [1] which is quoted at some length in the present chapter, will prove illuminating in this regard. A study of new banks organized during the war is interesting, not so much because of the importance of the banks, but primarily because it will reveal a new trend, and a disposition to depart from long-established policy and practice. Not the least important phase of this trend is the changes and developments in the joint-stock banks themselves. A study of the functions of the banks in relation to war finance would not be complete, therefore, without reference to the qualitative changes which war psychology and plans for the post-war period early began to bring about.

I. NEW POLICIES IN BRITISH BANKING

THE changes which took place in British banking during the war were not so much new departures in policy, as an extension and swifter development of tendencies which had already been manifest before the war. Thus the banking amalgamation movement was by no means a departure, though the proportions it assumed were without precedent.

[1] Cd. 8346.

There was one change, however, which constituted a greater break with the past than was perhaps fully realized. This was the enhanced interest and participation taken by British bankers in international finance. Formerly the banker accepted the instructions of a customer in respect to his foreign financial requirements and executed them through the agency of a correspondent. The correspondent furnished the necessary information, handled the details of the transaction, collected and remitted the proceeds of bills. Now the banks established departments *ad hoc*; opened in many instances branches in foreign centers and functioned through these branches as they formerly did through outside agencies. The tendency was to get closer to industry and trade, to foster business, and to render increased "service" to British manufacturers seeking markets abroad.

This development manifested itself in various ways. First there was the formation of the British Italian Corporation— an institution designed to promote trade between England and Italy; then the British Trade Corporation and the British Overseas Bank were formed, the first with the object of promoting trade relationships with those countries where Germany had a strong hold before the war: the second for the purpose of supplementing the facilities of a group of London and provincial banks desirous of direct representation in the foreign field. A number of smaller institutions of a similar kind were also organized.

Another form the development took, likewise an innovation, was the growing connection between the big joint-stock banks and banking companies overseas; this does not refer to the working arrangements arrived at between the various banks, such as that established between the National Provincial and Union Bank and the London and Brazilian Bank in July, 1919, but to the practise whereby the capital of overseas banks was acquired by British banks.

Examples of this were the purchase by Lloyd's Bank of practically the entire capital of the London & River Plate Bank; later the buying of a substantial interest in the National Bank of New Zealand; and in 1919 the acquisition of a block of shares of the Bank of British West Africa. Another instance of a similar kind was the acquisition by Barclay's Bank of shares in the Colonial Bank.

Several features of this new policy were the subject of criticism. One, which is, however, an almost necessary consequence of a policy of amalgamations, was the interlocking of directorates. Another, of more importance, was the locking up of capital in other banks in a manner that would not lead to ready realization should the necessity arise. This applied more particularly where the whole of the share capital had been acquired, for in an instance of this kind it would be impossible in an emergency for the parent bank to attempt to realize these assets by endeavoring to dispose of the shares on the market. Every bank must be prepared for a crisis, even though such an eventuality be extremely remote. In a crisis, when a bank would be having large demands made upon it by its customers, similar demands would in all likelihood have to be met by its affiliated undertakings. Hence at a time when the demand of its customers was particularly heavy the parent bank would have to come to the support of the banks whose capital it controlled. The implications of this are apparent.

II. BRITISH BANK AMALGAMATIONS

The amalgamation movement in British banking which had resulted in the reduction of the number of banks in Great Britain from 155 in 1895 to 77 in July 1914, received its greatest stimulus from the demands placed on banking facilities by the government's operations in financing the war. This movement, which reached a climax in the latter

TABLE I. CAPITAL, SURPLUS AND DEPOSITS "BIG FIVE" BEFORE AND AFTER AMALGAMATION

Bank	Paid-up Capital		Surplus		Deposits	
	Before Amalgamation	Dec. 31, 1918	Before Amalgamation	Dec. 31, 1918	Dec. 31, 1913	Dec. 31, 1918
	£	£	£	£	£	£
London Joint City & Midland	....	7,172,697	....	7,172,697	......	334,898,435
London City and Midland	5,188,840	....	4,342,825	....	105,637,449	......
London Joint Stock	2,970,000	....	1,325,000	....	37,637,945	......
Lloyds	....	8,954,056	....	9,000,000	......	266,808,130
Lloyds	5,008,672	....	4,000,000	....	104,305,863	......
Capital & Counties	1,750,000	....	800,000	....	39,958,096	......
London County Westminster & Parr's	...	6,850,990	....	7,430,086	......	262,857,781
London County & Westminster	4,138,005	....	4,727,949	....	88,313,651	......
Parr's	2,423,530	....	2,100,000	....	49,904,858	......
Barclay's Bank	....	7,289,444	....	6,000,000	......	239,660,041
Barclay & Co.	3,600,000	....	1,600,000	....	60,805,754	......
United Counties Bank	1,193,332	....	765,000	....	......	......
London & South-Western	1,200,000	....	1,000,000	....	21,521,018	......
London & Provincial	1,000,000	....	1,650,000	....	20,246,006	......
National Provincial & Union Bank of England	....	5,476,884c	....	4,850,000c	......	200,864,639
National Provincial Bank of England	3,000,000	....	1,800,000	....	67,882,423	......
Union of London & Smith's	3,554,785	....	1,500,000	....	42,083,506	......
Total	35,027,164	35,724,071	25,610,774	34,452,783	638,268,569	1,305,089,035

half of 1917 and the first few months of 1918, reduced twelve of the largest joint-stock banks in London to five, simultaneously reducing the number of clearing banks in the city from seventeen to eleven.

A graphic idea of the change which has come over the character of British banking in the five years 1914 to 1919 can be gained by a study of the table opposite, contrasting the paid-up capital and surplus of these twelve banks before their amalgamation, and their deposits and current accounts at the end of 1918, with the corresponding items of their present representatives at the end of 1913. In comparing the later deposits with those of 1913, allowance should be made for the enormous increase due to government borrowings.

To understand how rapid was the process of amalgamation while at its height, a brief survey of the operations during November 1917, and the few months following is in place. In November occurred the amalgamation of the London & South Western Bank with the London & Provincial Bank, and the following month that of the National Provincial Bank of England with the Union of London & Smith's Bank. In February, 1918, the London County & Westminster Bank joined with Parr's Bank, and two weeks later in the same month, the London City & Midland Bank absorbed the London Joint-Stock Bank. These consolidations coming so closely together created considerable anxiety lest the process should go too far and the amount of competition necessary to healthy banking should be eliminated. In consequence the Treasury requested the banks, and they agreed, to submit all proposals for further amalgamations to it for approval. Notwithstanding this anxiety relative to combinations the Treasury subsequently sanctioned the fusion of Barclay's Bank with the London Provincial & South Western Bank, which latter was an amalgamation of a few

months previous; the absorption of the Capital & Counties Bank by Lloyds Bank, and the amalgamation of the Bank of Liverpool with Martins Bank. A number of smaller consolidations took place in 1919 which are dealt with below.

We shall now trace more in detail the operations which in four years resulted in the consolidation of 12 of the largest banks in London into five separate organizations.

(a) *London Joint City & Midland Bank, Ltd.*

In February, 1918, the London City & Midland Bank took over the London Joint Stock Bank, becoming the London City & Midland Bank, and regaining supremacy in the field of deposit liabilities. In January 1919, the capital and reserves were both increased to £8,171,417; later in the year they were again both increased to £8,414,872. The Belfast Banking Company, with a capital of £500,000 and equal reserves, had been purchased in July 1917.

(b) *Lloyds Bank, Ltd.*

Amalgamation of Lloyds Bank, Ltd., with the Capital & Counties Bank, Ltd. took place in July, 1918, the combination retaining the name of the former. In the same month the new bank purchased the National Bank of Scotland, Ltd., with paid-up capital of £1,000,000 and reserves of £800,000 and the London & River Plate Bank, Ltd., with paid-up capital of £1,000,000 and reserves of £2,000,000, increasing its own paid-up capital to £8,954,056 and its reserves to £9,000,000.[1] By preserving the Bank of Scotland as a separate entity it was possible to continue the note-issue privilege which it held. In September, 1919, the West Yorkshire Bank, Ltd., amalgamated with Lloyds Bank, Ltd. This bank had a paid-up capital of £400,000, with the head office in Halifax and 34 branches.

[1] Subsequently in 1919 capital and reserve were increased to £8,984,056 and £9,071,250 respectively.

(c) *London County, Westminster & Parr's Bank, Ltd.*

The consolidation of the London County & Westminster Bank, Ltd., with Parr's Bank, Ltd., in February 1918, under the name of the London County, Westminster & Parr's Bank, Ltd., raised it for a time to second place in point of deposit liabilities among the banks of Great Britain. In January, 1919, the paid-up capital was increased to £8,500,000 and the reserve to £8,750,000. The London County & Westminster Bank (Paris), Ltd., with paid-up capital of £400,000, formed by the bank in 1913, is a subsidiary. The Ulster Bank, Ltd., with paid-up capital of £500,000 and reserves of £700,000, was acquired in October 1917 and the Nottingham & Nottinghamshire Banking Company was absorbed in December 1918. This bank, established in 1834, had 38 branches and sub-branches and deposits amounting to about £5,000,000. Its subscribed capital was £1,440,000, of which £350,000 was paid up.

(d) *Barclay's Bank, Ltd.*

Barclay's Bank made several amalgamations. In March 1916, occurred the amalgamation of Barclay & Co., Ltd., with the United Counties Bank, Ltd., under the name of Barclay's Bank. In December 1917, the London & South Western Bank, Ltd., joined with the London & Provincial Bank, Ltd., as the London Provincial & South Western Bank, Ltd., and in July 1918, this new bank was in turn amalgamated with Barclay's Bank, the latter name being retained. The amalgamation of the London & South Western with the London & Provincial Bank was noteworthy as the first case in several years where two *clearing* banks had consolidated, and also differed from other recent fusions, which had largely taken the form of the purchase of the shares of smaller banks by larger clearing banks. Barclay's Bank is jointly interested with Cox & Co., in the French

firm of the same name, which has a paid-up capital of £100,000, and is also interested in the British Bank of South America, Ltd., with paid-up capital and resources of £1,000,000 each, and in the Colonial Bank Ltd., with paid-up capital of £600,000 and reserve of £325,000.[1] With the purchase by Barclay's of the business of Messrs. Gillett & Co. of Banbury and Oxford, late in 1919, one of the very few remaining private banks possessing the privilege of note issue disappeared.

(e) *National Provincial & Union Bank of England, Ltd.*

The National Provincial & Union Bank of England, Ltd., resulted from the consolidation of the National Provincial Bank of England, Ltd., with the Union of London & Smith's Bank, Ltd., in December 1917 and was spoken of then as "quite the most important banking combination which has taken place in modern times," although destined soon to be exceeded in magnitude by several others. The firm of W. & J. Biggerstaff was absorbed in November 1918 and the following month the Bradford District Bank, with paid-up capital of £344,000 and reserves of £350,000 was also absorbed. Early in 1919, the paid-up capital was increased to £7,462,800 and reserves to £6,371,912.

The National Provincial and Union Bank of England, Limited, absorbed the Sheffield Banking Company, Limited in August 1919. By the original arrangement six shares of £20 each, £4 paid, of the Sheffield Banking Co., were to be exchanged for every share of the National Provincial's £50 each, £17.10 paid up. The Sheffield Banking Co., Ltd., which had 29 branches and deposits amounting to £6,930,385, was established in 1831. The circular issued by the Sheffield Banking Company on the subject stated that though the

[1] In November 1919 the capital had increased to £8,820,356 and the reserve to £7,000,000.

Sheffield Banking Company had for many years past advocated the maintenance of local banks, "they recognize that the war has materially altered the economic conditions of the world, and they anticipate that demands will be made for greatly increased banking accommodation when general trading is resumed. It is solely the present national situation that has been the determining factor in the change of policy." The capital of the Sheffield Banking Company amounted to £1,154,000, of which £404,075 are paid up.

(f) *Miscellaneous Combines*

During July 1914 two noteworthy fusions took place, the absorption of the long famous private firm of Robarts, Luddock & Co., with capital and reserves of £500,000, by Coutts & Co., with paid-up capital of £800,000 and reserves of £700,000, which took over the former firm's clearing privilege, and the absorption of the North Eastern Banking Company with paid-up capital of £385,668 and reserve of £180,000, by the Bank of Liverpool, Ltd. In November 1918, this bank amalgamated with Martin's Bank, Ltd., as the Bank of Liverpool & Martin's, Ltd., bringing the paid-up capital to £2,046,390 and reserves to £1,400,000. In October, 1919, the Bank of Liverpool and Martin's amalgamated the Halifax Commercial Bank, Ltd., with a paid-up capital of £300,000.

The National Provincial & Union Bank of England and Lloyd's Bank are joint proprietors of Lloyd's Bank (France) & National Provincial Bank (France), Ltd., with paid-up capital of £480,000. Lloyd's is interested with the London County, Westminster & Parr's Bank and with the Credito Italiano in the British Italian Corporation, with subscribed capital of £881,680, fully paid up and reserves of £83,-418. William Deacon's Bank is interested in the London & Brazilian Bank, Ltd., with paid-up capital of £1,250,000

and reserves of £1,400,000, and in the Anglo South American Bank, Ltd., with authorized capital increased in October 1919 from £5,000,000 to £10,000,000, issued capital of £6,000,000 and paid-up capital of £3,000,000. This latter bank holds the controlling interest in the Commercial Bank of Spanish America, Ltd., with subscribed capital of £261,417, fully paid up, and reserves of £35,314.

An important banking development which took place in April 1919 was the linking up of the Royal Bank of Canada with the London County and Westminster. The former bank has most important connections with the West Indies including Cuba, and elsewhere; thus is given another example of the significant extension of business influence of the big British institutions.

(g) *Community of Interest between Barclay's Bank, the British Linen Bank, and the Union Bank of Manchester*

This arrangement took place in November 1919. The issued capital of Barclay's consisted of 857,859 "A" shares of £4 each, fully paid, and 5,390,000 "B" shares of £22 each, £1 paid. In connection with the affiliation of the banks it was found necessary to make a rearrangement of Barclay's capital, under which the existing "A" capital would remain and be held as before the amalgamation, while the existing "B" capital would be converted into 10,780,000 "B" shares of £1 each, fully paid.

Between them the three banks possessed 1,684 branches while deposits showed a total at this time exceeding £325,500,000. The paid-up capital of the three banks aggregated £10,747,332 and the reserves £8,775,000.

The British Linen Bank and the Union Bank of Manchester continued to operate as separate entities, Barclay appointing two directors on each board.

The arrangement with regard to the "B" shares received

a good deal of adverse criticism, for it was contended that the former uncalled liability on the part of the "B" shareholders gave a reserve of security to depositors. Some authorities, however, considered it a development well worthy of imitation. The conversion of the "B" shares into £1 shares, i. e. into fully paid shares, would make them more marketable, and as fully paid shares they should become more and more widely held, and thus help to broaden the whole basis of the bank as a great popular cooperative undertaking.

III. JOINT-STOCK BANKS (AMALGAMATIONS CONTROL) BILL

(a) *Provisions of the Bill*

On March 11, 1918 a treasury committee, with Lord Colwyn as chairman, was appointed to consider the question of bank amalgamations, and as a result of its report, dated May 1, 1918, the Chancellor of the Exchequer on April 15, 1919, proposed in Parliament a Joint-Stock Banks (Amalgamations Control) Bill, the principal clause of which reads as follows:

> Except with the previous approval of the Treasury and the Board of Trade, given on an application made for the purpose under this Act, and subject to compliance with any conditions attached to the approval, it shall not be lawful for any joint-stock banks:
>
> (a) to amalgamate with any other banks; or
>
> (b) to transfer or sell its business or any part of its business to any other bank, or to acquire the business of, or any part of the business of, or any interest in, any other bank;
>
> and
>
> except with such approval, and subject to such compliance, it shall not be lawful for any person being a director of a joint-stock bank to become a director of any other joint-stock bank;

provided that nothing hereinbefore contained shall make it unlawful for any person to hold any directorship which he holds at the commencement of this Act.

Considerable opposition to the bill developed in the City because it placed such arbitrary powers in a committee of two, in whose judgment and integrity there could not always be unfailing confidence.[1] The Bill was subsequently withdrawn and did not become a law.

(b) *Discussion of Amalgamation Movement*

It is perhaps still too early to reach any definite conclusions as to the net good or evil of the amalgamation movement, though it must be said that events have thus far not justified the apprehensions of its opponents. The government committee appointed to investigate the question in its report[2] dated May 1, 1918, saw its way clear to make few specific recommendations. The increasing speed and magnitude of the movement was viewed at the time with alarm in some—and influential—sections of the financial press, and there was widespread feeling that, even though most proposed amalgamations were allowed, governmental supervision and control in some form should be maintained. Of the several and large proposals for combines put forward after the assent of the Treasury began to be required, only one, that of Lloyd's Bank with the National Bank of India, was forbidden, and this because of the opposition of the Indian Government.

In considering the effects of amalgamation on the country at large, it should be remembered that there were fewer than 80 banks in all of Great Britain. The 12 representatives in 1913 of the "Big Five" of today had no less than 5,000 offices in the British Isles, and as amalgamation re-

[1] See p. 217. A Treasury Committee had been in fact exercising control over amalgamations pending the enactment of this Bill.

[2] Report of the Treasury Committee on Bank Amalgamations, May, 1918, Cd. 9052.

duced their number, the number of branches might also be expected ultimately to diminish, though the immediate policy was to maintain all branches. It is certain that the provinces viewed the progress of amalgamation with more alarm than the City, and it was felt that with their increased resources the big banks would pay attention to foreign trade to the detriment of domestic. There was also the argument against concentrating such enormous power in the hands of a very few men, and this gave rise to the fear that the process might eventually lead to a state monopoly of banking.

One feature brought out in the financing of the £4,000,000 acceptance credit for Belgium was that the larger banks seemed not to have been accustomed to the management of the very large funds they had at their command. A bank with, say, double its past resources was very wary about accepting a risk half of which it would formerly have easily taken. It was pointed out that this timidity would probably soon vanish, but there is always a natural tendency for a banker to spread his risks. This was put forward as an argument that smaller borrowers would benefit rather than be injured by the large amalgamations.

The writing down of bank capital was one of the effects of the amalgamations which the committee on Bank Amalgamations pointed out. The following figures, taken from the *Economist,* show how comparatively small are the capital and reserves of English joint-stock banks:

Year	Paid-up Capital and Reserves	Deposits	Per cent Ratio
	£	£	%
1890	68,000,000	369,000,000	18
1895	69,000,000	456,000,000	15
1900	79,000,000	587,000,000	13
1905	82,000,000	628,000,000	13
1910	81,000,000	721,000,000	11
1915	82,000,000	993,000,000	8
1917	84,000,000	1,365,000,000	6

The total paid-up capital and reserve fund of the "Big Five", plus that of William Deacon's and Martin's, on December 31, 1918 was approximately £75,000,000 while the combined deposits and acceptances of the same banks was £1,421,000,000, showing a ratio of 5 per cent. After December 31, 1918 there were some increases in capital, which raised the percentage perceptibly.

In certain quarters it was held that the progress of amalgamation considerably altered the former character of the City's banking facilities. In the past the City of London was remarkable for the completeness of its numerous banking and financial facilities, and the specialization which was found there in all branches made for great perfection in each detail of banking. But now the clearing banks, which were formerly essentially deposit banks, became commercial banks, began reaching out for foreign business, and even began to underwrite security issues. While this change made for a more intimate cooperation between the various banking elements which should have made them capable of rendering greater service to their clients, the joint-stock banks showed little disposition to set up any of the special facilities for business-getting which characterized the German banks before the War. They presented increased facilities to industry and trade, but few new faculties. They were, however, more concerned about industry than they had been before the war and were on the whole generous in advancing funds for the conversion of war plants to peace plants.

(c) *Summary of the Report of the Committee on Bank Amalgamation* [1]

1. *Writing down of Bank Capital:* "The proportion of capital to deposits is now so small in the case of English Joint-Stock Banks, even excluding the temporary war in-

[1] Report of the Treasury Committee on Bank Amalgamations, May, 1918, Cd. 9052.

crease in the amount of deposits, that any further shrinkage of bank capital is clearly undesirable, in the interest of depositors, if it can be avoided. . . . Amalgamation schemes usually mean a reduction in the total paid-up capital and uncalled liability of the two preamalgamation units." For example, the amalgamation of the National Provincial Bank of England, Ltd., with the Union of London and Smith's Bank, Ltd., resulted in a reduction of over £1,000,000, or 16 per cent in the total paid-up capital and of over £9,000,000 or over 48 per cent in the uncalled liability of the Union shareholders.

The amalgamations of three out of the "Big Five" resulted immediately in capital reductions. The capital of the London County, Westminster & Parr's Bank, Ltd., however, was slightly increased and that of Lloyds was increased more than £2,000,000. Reference to Table I, on p. 216 will show, therefore, that the aggregate capital of the five banks at the end of 1918 was somewhat larger than before amalgamation. The Committee's report was made in May, 1918, and Lloyds amalgamations took place in July, 1918. The statement of the Committee was therefore correct at the time of writing. It is not unlikely that the increase in the case of Lloyds was due to Treasury insistence as a result of the Committee's report. As a matter of fact, early in 1919 several of the banks considerably increased their capitalization, and subsequently the others did likewise. The Committee's warning seems to have served its full purpose.

2. *Dangers of reduced competition:* "Banks vary very much in their willingness to allow reasonable overdraft facilities, and sufficient money and cheap enough money has only been obtained hitherto by resorting to different banks, the number of which is now falling steadily." On this ground there have been a number of protests "suggesting that it is not in the national interest that large funds be-

longing to the public should be in the hands of a few companies. . . ."

"that the world-wide fame of the London Market before the war was due to the freedom with which London bills could be negotiated, owing to the ease with which Discount Houses obtained ample funds from a wide number of banks, and that the fewer the lending constituents in the discount market, the less flexible is the market and the less fine the rates. The number of members in the Clearing House is already becoming very small, and any further decrease in the number of its constituent members or any greatly preponderant power on the part of particular members might impair confidence in its smooth working and raise apprehensions in the market. Moreover, it is pointed out that a reduction in the number of important banks must mean, and has already meant, a reduction in the number of first-class acceptors of bills, and that if this reduction proceeded very far, it would become a question whether the Bank of England would not have to place a limit on the amount of acceptances which they would take from any particular bank doing a large accepting business, and whether Continental buyers would not limit the number of bills taken by them."

3. *The danger of monopoly:* "There is a real danger lest one bank by the gradual extension of its connections may obtain such a position that it can attract an altogether preponderant amount of banking business; or, alternately, lest two banks may approach such a position independently and then achieve it by amalgamation. Any approach to a banking combine or money trust, by this or any other means, would undoubtedly cause great apprehension to all classes of the community and give rise to a demand for nationalising the banking trade. Such a combine would mean that the financial safety of the country, and the interest of individual depositors and traders, would be placed in the hands

of a few individuals, who would naturally operate in the interests of shareholders. Moreover, the position of the Bank of England which would, it may be assumed, stand outside any such trust, would be seriously undermined by so overwhelming a combination, and the Bank might find it extremely difficult to carry out its very important duties as supporter and regulator of the Money Market. Any such result would, in our opinion, be a grave menace to the public interest."

The chief advantages pointed out by the Committee are as follows:

(1) *The convenience and gain to trade secured by an extension of Bank areas.*

This is an obvious advantage, but as the Report quite correctly adds—"If both the amalgamating units have, before amalgamation, lent up to their full resources, home trade *as a whole* cannot gain any increase in accommodation as a result of the amalgamation. Except at the expense of smaller traders, large trade combines could not obtain larger advances in all from the combined resources of the amalgamation than they obtained from the separate banks before." Moreover, the advantages thus gained would be largely counteracted by an attendant evil of which much complaint was heard, namely, that small local interests would not be able to obtain accommodation so easily as they could when the smaller banks existed and made it their business to know the local people and the extent to which credit should be granted them.

(2) *The advantage of large size of banks.*

"Numerous representations have reached us to the effect that large banks are better for traders, and particularly for large traders, than small banks because, with their larger

resources, they can safely make individual advances on a more generous scale. And it is argued that banks must grow now to keep pace with the growth in size of business houses generally, and to enable them to deal with the demands of after-the-war trade both at home and abroad." This is a point upon which it was very difficult to reach a conclusion. While it was very desirable that the banking interest should be adapted to the requirements of after-the-war business, "the point with regard to size is one of degree only and it is a question whether the continued practice on the part of exceptionally large firms of resorting to two or more banks instead of one for advances would not suffice to meet all their needs, and whether the existing large banks are not in fact large enough to meet the requirements of the immediate future, at any rate if supplemented, as far as may be necessary, by combinations for special purposes on the lines of German 'Konsortiums' or otherwise."

Mr. Sidney Webb, arguing for a Government monopoly of banking, contends that "the fusion of large banks is an economically inevitable development at a certain stage of capitalist enterprise and one which cannot effectively be prevented".[1] Sir Charles Addis, Manager of the Hong Kong and Shanghai Banking Corporation, arguing against the continuation of large banking consolidations, pointed out[2] that "the insolvency of one of the great banks would involve such widespread disaster that no government could stand aside. They would be compelled to make use of the national resources in order to guarantee the solvency of private banks. From government guarantee to government control is but a step, and but one step more to nationalization. We are playing into the hands of Mr. Sidney Webb and the Socialists."

[1] *Contemporary Review*, July, 1918.

[2] *Edinborough Review*, July, 1918.

Mr. Hartley Withers[1] weighs the arguments for and against a state monopoly in banking, and while admitting that a banking monopoly in private hands might squeeze the public to the point of restricting banking facilities and making them dearer, says, "on the other hand, it may very fairly be argued that modern business has perceived the great advantages of a big turnover and small profits on each transaction. The experience of the great insurance companies and of great catering companies and the enormous private organizations such as the Imperial Tobacco Company, has shown the enormous advantage of providing cheap facilities to the largest possible number of customers; so that fears of natural restriction of banking facilities through monopoly, if they cannot be set altogether aside, are by no means a certain consequence even of the establishment of monopoly in private enterprise."

IV. NEW COMPANIES FORMED DURING THE WAR

(a) *The British Trade Corporation*

The beginnings of the British Trade Corporation date from July 1, 1916, when the Board of Trade appointed a committee with Lord Faringdon as chairman, "to consider the best means of meeting the needs of British firms after the war as regards financial facilities for trade, particularly with reference to the financing of large overseas contracts, and to prepare a detailed scheme for that purpose."

(1) *Report:*[2] On August 31, 1916, the committee reported, Mr. Gaspard Farrer dissenting:

We recognize—that the British manufacturer may be frequently in want of finance of a kind which a British joint-stock bank could not prudently provide, whereas the German banks

[1] *War-Time Financial Problems*, p. 172.

[2] Report of the Committee on Financial Facilities for Trade 1916. Cd. 8346.

in particular seem to have been able to afford special assistance at the inception of undertakings of the most varied description, and to have laid themselves out for stimulating their promotion and for carrying them through to a successful completion. We conclude, therefore, that there is ample room for an Institution which, while not interfering unduly with the ordinary business done by the British joint-stock banks, by Colonial banks, and by British-foreign banks and banking houses, would be able to assist British interests in a manner that is not possible under existing conditions.

Such an institution, the report of the committee went on to observe, might be beneficial to the development of British industries by making advances for the extension of existing manufacturing plants, or by the amalgamation or coordination of works, so as to reduce cost of production. It would assist these works to obtain orders abroad, and give them reasonable financial facilities for executing these orders. It should give preference to orders to be executed in Great Britain, and could also take a leading part in the inception of transactions and assist in connection with the machinery of overseas business.

In the case of German manufacturers [says the report] it frequently happens that on the board of the manufacturing company there is a representative of a bank, and there seems little doubt from an examination of the information which is available that the German banks have exercised an amount of control over the manufacturing concerns in which they are interested which would not be possible, even if it were desirable, in the United Kingdom A large number of our manufacturing undertakings are wealthy concerns and would not tolerate for one moment interference by bankers in their affairs, and indeed would probably resent any inquiry into the nature of their business arrangements. Such manufacturing concerns, however, do require assistance when they transact overseas business. Take as a single instance the case of a Midland manufacturer selling

goods to Italy. The Italian buyer has been accustomed to long credit, and if long credit is refused the business will probably be impossible. The manufacturer sells goods for, say £50,000, and the payment of that price would leave him with considerable margin of profit, but the offer of the Italian buyer to pay him the equivalent of £50,000 in lire at six or twelve months is not attractive. He would much rather accept a lower figure than £50,000 for a clean cash transaction in sterling, and it is in connection with such business as this that an Institution of the kind contemplated would be able to act as intermediary (taking part or the whole of the financial liability) with profit to itself and satisfaction to the manufacturer.

Or to take another case, that of a contractor who has entered into a contract with a foreign Government, payment being made as works proceeded, such payment being possibly in paper in a foreign currency, the contractor in that circumstance would willingly share his profits with an Institution which would be responsible for the finance of the securities receivable by him.

Having assured ourselves [the report concludes] that the creation of an Institution of the character referred to above would not unduly interfere with existing banks, banking houses, or financial institutions, we recommend the formation of a new Bank to fill the gap between the home banks and the Colonial and British-foreign banks and banking houses, and to develop facilities not provided by the present system.

(2) *The Corporation Organized:* The committee's recommendations resulted in the granting of a royal charter to the British Trade Corporation on April 21, 1917, with broad powers to accomplish the purposes outlined in the report.

The second general meeting of the shareholders of the Corporation was held on February 6, 1919, and the statement for the year 1918 was presented. A copy of the statement is given below. The Governor, Lord Faringdon, pointed out that the activities of the company, and consequently its profits, had been very much limited because of

the very small volume of foreign trade permitted during the War.

BRITISH TRADE CORPORATION

(Incorporated by Royal Charter)

BALANCE SHEET AT 31ST DECEMBER, 1918

ASSETS

	£	s.	d.
Cash in hand at Bank of England	75,345	15	10
Money at Call and Short Notice	610,000	0	0
British Treasury Bills	1,000,000	0	0
Investments (including £350,000 National War Bonds and £125,000 Exchequer Bonds)	572,889	17	8
Bills Discounted, Loans, Advances and Sundry Debtors	1,090,041	3	5
Liability of Customers for Acceptances as per contra	212,181	2	8
Capital in Subsidiary Companies	367,200	0	0
Furniture, less Depreciation	2,215	16	0
Stamp Duty on unissued Capital	20,000	0	0
	£3,949,873	15	7

LIABILITIES

	£	s.	d.
Capital—			
Authorized— 1,000,000 shares of £10 each £10,000,000			
Issued—			
200,000 Shares of £10 each, fully paid	2,000,000	0	0
Current, Deposit and other Accounts .... (Including rebate of Interest on Treasury Bills and Bills discounted,)	1,673,440	8	9
Acceptances on Account of Customers	212,181	2	8
Profit and Loss Account			
As per Account	64,252	4	2
NOTE—There is a Contingent Liability of of £4,485 18*s.* 9*d.* in respect of Bills guaranteed, and £191,375 in respect of uncalled Captal on Investments held.			
	£3,949,873	15	7

A number of important subsidiary companies were organized, however, during the year. These subsidiaries were:

1. The Trade Indemnity Company, organized in April, 1918, was for the purpose of foreign credit insurance, with a capital of £100,000, all the stock of which was held by the Corporation. Its shares were issued to the Corporation at a premium of 20%, and 20% was called up; hence the Corporation's actual investment was £40,000.

This indemnity company took over the credit insurance business of the Excess Insurance Company, Ltd. The new company was to issue *Fidelity Bonds; Contract Bonds; General Policy Insurance,* covering two-thirds of the client's whole turnover, against ultimate loss; *Resale Loss,* to cover a proportion of such losses as might arise should a forced resale of goods become necessary in consequence of buyer's becoming insolvent and thereby unable to take up shipping documents; *Whole Account Insurance,* covering a proportion of the losses in one year in excess of an agreed percentage of the loss on turnover, to be borne by the assured (the proportion was arrived at by striking an average of the insured's losses over a period of years, and requiring the insured to carry 25% of the risk); and *Specific Account Insurance,* covering particular accounts up to three-fourths of the amount of the debt (this to insure against the insolvency of the debtor or to protect him against the dishonoring of any duly accepted bill).

The matter of rate was variable, depending largely on the particular circumstances of each case. It was expected to range from ½ to 2½%. In special cases the rate might be as high as 12%. The company decided to depend for its credit information largely on the Board of Trade, which has a very extensive intelligence department.

2. The Portuguese Trade Corporation. Organized also with a capital of £100,000. Its president was a Portuguese,

Dr. B. Cabral. The management of the company was in Lisbon, and its purpose was specifically to compete with the German interests which were so active in Portugal in the prewar period.

3. The Anglo-Brazilian Commercial & Agency Company, Ltd. Its capital was £125,000, of which the British Trade Corporation subscribed one-half and the London & Brazilian Bank the other half. Here again the purpose was specifically to take over German business in Brazil. To accomplish this purpose, the company planned to give financial assistance directly to British firms where it was needed, and also to establish new firms in the German sphere of influence.

4. The Levant Company, Ltd. This was capitalized at £1,000,000, of which the British Trade Corporation in April 1919 took £200,000 Deferred Shares at £1 each. The company was formed to develop trade between Great Britain, the Levant, and the Near East, and it aimed at reviving in modern form the commercial side of the activities of the old Levant Company, which during the 16th and 17th centuries was the recognized spearhead of British influence in the Near East. As a nucleus for its operations the business of Messrs. Henderson, Lane & Company was acquired as from January 1, 1919, as well as the whole of the share capital of Hendersons (Manchester) Ltd. The company also acquired at par 7,000 of the Preference shares of £10 each of J. W. Whittall & Company, of Constantinople. To assist the work of the Levant Company, the Corporation acquired the whole share capital of the National Bank of Turkey. Here again the company aimed to go out actively after business in this part of the Mediterranean area hitherto dominated by Austrian and German influence.

5. The Corporation acquired a small interest in the Inter-Allied Trade & Banking Corporation, Ltd., which had a share of capital of £1,000,000. It had as its chairman Sir

Henry Birchenough, and as its managing director Mr. U. F. Wintour, late Director of Army Contracts and permanent Secretary of the Ministry of Food. Its sphere of action was Belgium and northern France.

The corporation planned to " father " small corporations for whose products a foreign market could be found. Much that the Webb Law permits small manufacturers to do in the United States the Corporation planned to take the initiative in doing in Great Britain.

On the other hand, it aimed to be of assistance to the large engineering and electrical contracting firms in financing for them enterprises which involve a capital of less than £250,000. The securities of corporations with a capital of less than that amount cannot be listed on the Stock Exchange. Hence, these lesser investments, which would in the aggregate mean a large volume of orders for British firms, would in the future find the necessary underwriting and support. The Corporation's plans were ambitious, but its capital large enough to do all that it hoped to do.

It strongly protested that it did not wish to encroach on the activities of " existing banks, banking houses, and financial institutions," and it had agreed with the joint-stock banks not to *seek* deposits. Its early activities, as the balance sheet shows, were very largely devoted to helping the government finance the war, and there was some skepticism in the City as to the success of its very large aims. There was considerable opposition expressed in Parliament against the Corporation's wide powers when the charter was granted. Some outspoken criticism was also made of its program on the score that it was too German. It was said that it proposed to capture German business by the same methods that the Germans used, and which caused such severe criticism when those methods were being used against British business.

No specific instances were pointed out, but the open announcement of its intention to imitate German commercial policy excited suspicion in certain quarters where British traditions of free competition and *laissez-faire* in trade are strong. It represented a departure from "legitimate" British banking by combining the function of issue, acceptance, deposit, industrial investigation, insurance, etc., heretofore handled by separate organizations in London. It was the most significant development along the lines of new financial facilities for trade that has taken place since the war.

(3) *Post-war Activity of the British Trade Corporation:* With the signing of Peace, the British Trade Corporation began to show the activity of which it gave promise at the time of its organization. The Corporation was not particularly active during its first year because of the war, and it was unable to promote trade on a large scale immediately following the armistice because of the continuation of governmental restrictions. Toward the end of 1919 evidence of its activities began to appear. The first of these was the offering of shares in one of its subsidiary companies, the Levant Company, which was to develop trade in the Near East and particularly in Mesopotamia, where Great Britain was given a mandatory.

Later came an announcement of the formation of the South-Russian Banking Agency, Ltd., with a capital of £40,000 in shares of £10 each. Three of the large joint-stock banks cooperated with the British Trade Corporation in the organization of this new agency, the London County, Westminster & Parr's; Lloyd's; the National Provincial & Union. Representatives of these three banks and of the Corporation were placed on the Board of Directors. This indicated the policy of the large joint-stock banks to take a direct interest in foreign trade.

The Corporation opened an office in Danzig, and began stimulating the activities of its subsidiaries everywhere.

(b) *British Overseas Bank*

The British Overseas Bank began operations in July 1919. The banks behind this new enterprise were: The Anglo-South American; Glynn Mills, Currie & Co.; the Northern of Belfast; The Imperial Ottoman Bank; the Dominion Bank of Toronto; The Union of Scotland; Charles Hoare & Co., and William Deacon's. The capitalization was £2,000,000, half common and half preferred. The common was taken by the banks and the preferred was sold to the general public.

Mr. R. J. Hose, Managing Director of the Anglo-South American, was the moving spirit behind this new banking venture. Its purpose was to have a bank owned by banks which cover different fields, so that the facilities of the banks behind the enterprise might be available for the new bank, and the new bank in turn place branches in the places where none of the parties interested were represented. It is to be noted that the banks which made up the list included two London banks — Glynn, Mills, Currie & Co., and Charles Hoare & Co.; a Manchester bank with eighty branches throughout Lancashire and the textile district, and with branches in London—William Deacon's Bank; a Scotch bank; an Irish bank; a Canadian bank; a Levantine bank, and a South American bank. William Deacon's also has connections with the London & Brazilian Bank and the Commercial of Spanish America, so that with these and the Anglo-South American branches the new bank started with strong representation in Latin America.

Much stress was placed by the backers of the new bank on the mutual advantages which would come from the interrelation of these various interests. All would be interested

in the success and in the profits of the British Overseas Bank, and this would be a bond which would insure their close relationship in business within Great Britain and abroad. A saving would be made in charges on arbitrage transactions and in the fees for accepting bills and issuing letters of credit. The client, its organizers believed, would be assisted by the more effective control which the head bank would have over branches and which it could not exercise over correspondents. The Anglo-South American had been serving its clients by having a representative in the various branches of the William Deacon's Bank, most of which are in the industrial districts, who gave clients seeking foreign business personal assistance and advice. This plan was to be extended, and a very efficient service built up for assisting the manufacturer in finding the opportunities for foreign business, and educating him in the practices and customs of foreign buyers.

This bank undoubtedly represented an effort of the smaller banks to keep from being crowded out of the foreign field by the extension of the activities of the five big joint-stock banks. The London Joint City & Midland bank claimed to have the largest foreign business of any British bank, and it secured this business entirely through correspondents all over the world. It had no foreign branches whatsoever, but it had secured the business of most of the powerful banks in foreign countries. Its 1,300 branches throughout the United Kingdom and its large deposits, give it facilities which made it most desirable as the correspondent of a foreign bank. Lloyd's was extending branches into France and Belgium, and reaching out its control into the Colonies and South America. It had recently, as has been said, bought 50,000 shares of a new 100,000-share issue of the National Bank of New Zealand, and had taken over the London & River Plate Bank. The National Provincial &

Union Bank also had been making foreign extensions, having recently taken over the controlling interest in Lloyd's of France. These developments were forcing the smaller banks to combine, and because of their inability to get the representation of the large banks in foreign centers to establish branches directly in competition with the foreign banks and with their powerful rivals at home.

The late Sir Edward Holden did not believe that this plan would succeed, and he regarded the branch-bank method of getting business abroad as hazardous and costly. He cited to the writer an instance of a British bank which had been lending money on crops in France and which lost a sum of money equivalent to its total capitalization as a consequence. This he said was a danger which always existed in the case of branch banks where the home office cannot supervise closely the business that is done and the loans that are made. No loan is made in any of the 1,300-odd branches of the London Joint City & Midland without the approval of the managing director. Such a system of supervision cannot be maintained when branches are on the Continent or overseas. He regarded arbitrage as a small part of foreign business and the branch-bank argument for such business as without weight. The matter of service to manufacturers, he pointed out, was taken care of by the London Joint City & Midland Bank through traveling representatives who visit, for instance, a South American correspondent, and assemble the clients of that correspondent doing business in the United Kingdom, and discuss with them matters which tend to facilitate the business between the two countries. The same representative later returns to the United Kingdom, assembles the British manufacturers who are his bank's clients, and advises them of developments and of anything else of interest to them. This system, argued Sir Edward, gave all the service that is required and all that any branch bank can

give. The good will of the foreign correspondent and of the foreign buyer is retained by this method, while the setting up of a British branch bank to take over all the business, on the other hand, antagonizes and stirs up resentment. Sir Edward insisted that the success of his bank demonstrated that business can be secured and developed through correspondents. He criticized the policy of establishing branches of the joint stock banks on the Continent where they could get practically no deposits, and where they would be lending British deposits that were far more needed in Great Britain itself.

It seems clear that the "Big Five" joint stock banks of London will continue to make a serious bid for foreign business and give far more attention to it than they ever did before. They will undoubtedly try to get control of large Colonial banks in the way that they have amalgamated all the smaller banks of the United Kingdom; this policy has indeed already begun. Some opposition was to be expected to develop against this policy, and the Treasury may refuse to permit the buying up of the Colonial banks, as it did when it refused, owing to the protest of the Indian Government, to sanction Lloyd's efforts to get control of the National Bank of India. It is certain, however, that the movement of amalgamation will go on, and if direct buying of control is discouraged, the same object will be accomplished by other arrangements. It must be clear to anyone familiar with the situation that the "Big Five" with their hundred of branches and their enormous deposits will ultimately dominate the foreign as well as the domestic field.

(c) *The Anglo-Baltic and Mediterranean Bank*

This was a new banking company formed in August, 1919, to finance trade with the Baltic and the Mediterranean. Its capital was over a million sterling. A far-reaching pro-

gram had been prepared, including foreign exchange, insurance, shipping agency, stock and share business, an information and statistical bureau, a branch at Hull, and foreign agents and correspondents throughout the world. It was a further example of the newer tendency in British banking to take an increased interest in the financing of trade; for this institution was founded primarily to finance imports of raw materials and to provide facilities to British manufacturers, merchants and shipowners. It was contended that no British bank had yet attempted to cater comprehensively for the important business of the countries surrounding the Baltic and the Mediterranean. Support was to be given the bank by many of the principal banks and business houses in Scandinavia, the Ukraine, the Continent generally, and the United States. There was to be an exchange of directors with the Banca Bergamasca of Italy. There are 200,000 Ordinary shares of £5 each and 2,500 Founder's shares of £1 each.

(d) *The British Italian Corporation*

This bank was founded to develop trade between England and Italy, as before stated. Since its inception there has been a considerable development of its business connections which now number among its shareholders twenty-three important English banks, including four of the five leading London institutions, while the sister institution in Italy, the Banca Italo Britannica, has been further strengthened by an agreement with other Italian banks. The paid-up capital of the Corporation was increased during the year 1919 from £834,180 to £1,000,000.

V. REGULATIONS GOVERNING THE ESTABLISHMENT AND CONTROL OF BRANCHES BY THE BRITISH BANKS

British banks have normally been subject to practically no government regulations. Even money-market controls dur-

ing the war were effected by agreement with the Bank of England rather than by Parliamentary Act. The banks with the privilege of note issue such as the Bank of England and the Scotch and Irish banks exercising this privilege, are subject of course to regulations (under the Bank Act of 1844) as to the quantity of notes that can be put in circulation, and the joint-stock banks whose organization was provided for under the Parliamentary Acts of 1826, 1833 and 1844, are permitted to carry on a general banking business without the right of note issue. But any machinery for state inspection and control such as we have established in the United States for the national banks through the Comptroller of the Currency, and for the state banks under the state banking commissions, is utterly unknown in Great Britain. Percentage of gold reserves against deposits is determined by banking practice, not by statutes. There was proposed in Parliament a decree governing consolidation of banks and containing certain provisions against interlocking directorates, but this bill did not become a law.[1]

The "Big Five" banks do over seventy per cent of the banking business of the United Kingdom, and have close to 6,000 branches in London and throughout the provinces. These banks may establish branches wherever they wish, without governmental permission or special charter. In establishing branches in foreign countries they are subject only to the laws and restrictions of those foreign countries. In a word, banking ramifications other than amalgamations are absolutely free in Great Britain. Great Britain is a consistently *laissez faire* country. Such restrictions as were established on new capital issue, etc., were solely war measures and were removed as rapidly as the country reached a peace footing.

[1] The Amalgamation Control Act was not legislation against amalgamations, but provision for Treasury sanction. The bill was subsequently withdrawn.

The "Big Five" joint-stock banks have their own system of inspection and examination, sending men to visit the branches at least every eighteen months and occasionally more often, and the branches are very thoroughly controlled from the head office. No loans are placed in the provinces or in any of the branch banks in London itself, without the approval of the head office. No exchange business is done except from the main office or through the authority of the main office. There is a complete record in the main office of the branch clients' accounts, and while the local manager is expected to make recommendations, and does so with success because of his intimate contacts with the business interests in his district, all the accounts of every branch bank are under the scrutiny of officials in the head office who can readily detect the tendency of any clients to use bank credit improperly.

Where the bank has branches abroad, this type of supervision is naturally more difficult. This is one of the arguments often advanced against branch banking abroad. Banks, however, which have many foreign branches, advised the writer that they had experienced no serious difficulty in controlling their foreign branches, because they take great care to secure managers upon whom they can place great reliance, and who are required to follow closely general policies which are worked out by the general managers in the London office. Moreover, there is usually kept complete records of all the accounts of the foreign branches, and the accounts are very carefully scrutinized by managers in touch with the conditions in the particular country where the branch is established. One of the officials of a British bank with a large number of South American branches suggested in talking to the writer that America would, in developing foreign banking, be greatly handicapped by the lack of that which has been the great strength of British foreign bank-

ing, namely directing staffs who have had long and extensive foreign experience themselves, and who have come to high positions in the home offices through promotions from foreign branches. Experience with the customs and laws of these foreign countries is something which takes time to acquire and it can be learned only by long residence there. One of these managers cited an instance of how his bank had taken a loss on a purchased commercial bill which ran into a considerable sum because the law in the South American country where the branch was established did not hold the broker from whom the bill had been purchased, liable. This he said was one instance of what may occur continually, if the manager is not thoroughly versed in the commercial law of the country where the bank is established.

The British public is protected in its dealings with banks, by the integrity and long-established traditions of conservative banking practice, and the sense of responsibility to British trade and industry on the part of the heads and boards of directors of these institutions. The development of Great Britain has been slow and sure. Speculation in land and non-liquid assets has not been a temptation to banks as it has been in certain epochs in America. Losses and bank failures have been extremely rare, and all that governmental control aims to do in America has been accomplished in Great Britain without that control.

VI. TABLES RELATING TO THE "BIG FIVE" AND CONSOLIDATION

When the effect of consolidations is being discussed, two points are generally confused. The *qualitative* and the *quantitative* aspects are not properly distinguished, it being generally supposed that a conception of the strength of the combine derived from the consolidation as such will also give one a statistical measure of the success of the com-

bination movement as such. But this is not the case. The qualitative factor can be measured more or less by stating that " 70% of the deposits are now controlled by five banks ",

TABLE II

Concentration Movement in Great Britain

Control of Banks (including the Bank of England)

over Deposits. Based on "Statist" Returns

Deposits between	1913 No. of Banks	1913 Deposits (in mill. £'s)	1914 No. of Banks	1914 Deposits (in mill. £'s)	1915 No. of Banks	1915 Deposits (in mill. £'s)	1916 No. of Banks	1916 Deposits (in mill. £'s)	1917 No. of Banks	1917 Deposits (in mill. £'s)	1918 No. of Banks	1918 Deposits (in mill. £'s)
£m.10-£m.20	14	214	15	237	15	255	12	190	13	191	11	168
£m.20-£m.30	6	132	6	143	5	121	7	165	11	282	8	207
£m.30-£m.40	2	78			1	34	3	97			4	126
£m.40-£m.50	2	92	3	132	3	137	2	91	2	89	1	45
£m.50-£m.60			1	53	1	55	2	109	2	117		
£m.60-£m.70	2	129	1	67			1	62			1	63
£m.70-£m.80	1	71	1	75	1	82			1	75		
£m.80-£m.90	1	88										
£m.90-£m.100					1	90						
£m.100-£m.110	2	210	1	101	1	109	2	207				
£m.110-£m.120			1	118								
£m.120-£m.130			1	126			1	120	1	129		
£m.130-£m.140					1	130						
£m.140-£m.150					1	148						
£m.150-£m.160			1	155			1	151				
£m.160-£m.170					1	162			1	166		
£m.170-£m.180							2	353	2	351		
£m.180-£m.190												
£m.190-£m.200												
£m.200-£m.210											1	201
£m.210-£m.220												
£m.220-£m.230												
£m.230-£m.240									2	471	1	239
£m.240-£m.250											1	241
£m.250-£m.260												
£m.260-£m.270												
£m.270-£m.280												
£m.280-£m.290											1	281
£m.290-£m.300											1	297*
£m.300-£m.310												
£m.310-£m.320												
£m.320-£m.330												
£m.330-£m.340												
£m.340-£m.350											1	347
Totals	30	1014	31	1207	31	1323	33	1545	35	1871	31	2215
Aggregates	77	1142	69	1322		1433		1657		1909		2274

*Lloyd's Bank, inclusive of the River Plate Deposits £30.75 millions.

[1] In the first column of this table the deposits are shown in million pounds sterling. £m. 10–£m. 20 = 10 to 20 million pounds sterling.

or something to that effect: since this indicates the power which more or less can be exercised by a small group of bankers. But when we ask the question, to what extent are the consolidated banks doing a larger business than they were doing before they were amalgamated, we are testing the success of the combination movement from a different angle, and the important point is that the same series of statistical facts will not serve to measure both aspects of the consolidation movement. When we try to answer the *second* question, what we require is a *consistent basis of comparison,* and this can only be furnished by dealing with the proportion of the total business carried by the consolidated group *before and after* consolidation. We must in other words distinguish between the *process* of consolidation and the working of consolidation.

Table II deals with the first point—the process of consolidation.

It will be seen that comparing 1913 with subsequent years, though the number of banks with deposits of between £10,000,000 to £20,000,000 has only fallen a little, the deposits controlled by banks of this size have fallen by nearly £50,000,000. On the other hand, each succeeding year shows an increase in the size of the largest banks — a movement which can best be followed from the direction of the heavy line running across the table. One very significant feature which is revealed by the table is the differentiation of the banks into two distinct groups. If the blank spaces on the right of the heavy line are watched, it will be noted that their depth gets greater and greater as we pass from 1914 to 1918—until in 1918 we are faced by two groups of banks with no intervening connecting link, (a) a group of banks, 25 in number, with betwen £10,000,000 to £70,000,000 of deposits each; (b) a second group of banks, six in number (of which one is the Bank of England) with between £200,-

000,000 to £350,000,000 of deposits each; the middle group, in other words, has been swallowed up through amalgamation to form the very large banks, with this differentiation into a group of very large and a second group of relatively small banks. A position of unstable equilibrium is obviously reached, indicating the possibility of further amalgamations in the future. When we ask whether the consolidating groups are doing a larger proportion of the total business than the banks of which they are made up did before, we must deal with the second series of tables dealing with the "Big Five". It is again necessary to avoid the fallacy of thinking that the effect of consolidation could be watched by dealing with the percential changes in the types of business done by these groups before and after consolidation. Any effect which consolidation might have in this respect has been in the years 1913-1918 completely swamped by the war. But since the whole banking system has been exposed to the same influences in this period, it is possible by drawing a comparison between the system as a whole and the "Big Five" before and after consolidation, to measure the degree to which the system of consolidation is changing, not only control over the volume of deposits in a few hands, but the relative ratios of business done by consolidated and non-consolidated banks—or rather (since the "Big Five" represent only the extreme tendency of the general movement) the ratio of business done by the "Big Five" compared to what they did before. The facts in relation to this question are set out in Table III.

As far as the last item is concerned, only a very small change in the situation will be found: 2% over the whole period. The abrupt change in the percentage of Discounts and Advances and Investments in 1918 is due, at least in part, to changes in method of dealing with Treasury bills by one of the amalgamations, as is indeed

TABLE III

THE "BIG FIVE" COMPARED WITH THE BANKS OF THE UNITED KINGDOM AS A WHOLE (EXCLUSIVE OF THE BANK OF ENGLAND)

	1913	1914	1915	1916	1917	1918
Percentage of total Capital and Reserves represented by "Big Five"	56.1	56.6	56.7	67.3	57.4	60.0
Percentage of total Deposits of Banks represented by "Big Five"	67.4	68.1	68.4	68.5	68.8	68.7
Percentage of Acceptances of Banks represented by "Big Five"	60.3	63.0	65.2	70.7	66.8	74.6
Percentage of Deposits and Acceptances combined represented by "Big Five"	67.0	67.9	68.3	68.6	68.7	68.8
Percentage of Cash-in-hand and Call-Money represented by the "Big Five"	70.0	70.0	71.0	69.4	70.4	69.6
Percentage of Discounts and Advances represented by the "Big Five"	65.4	67.0	65.3	66.0	65.6	70.5
Percentage of Investments represented by the "Big Five"	54.0	55.1	63.5	62.7	62.5	56.3
Percentage of Aggregate Liabilities represented by the "Big Five"	64.8	64.9	65.9	66.4	66.6	66.8

obvious from the abruptness of the change. The only feature where the situation seems greatly to have changed is with regard to the item Acceptances; in 1913 the ratio of the "Big Five" acceptances to the total was 60%; in 1918 it was 74.6%. Here it would seem that the policy of Lloyd's Bank is having a distinct influence—between 1917 and 1918 the acceptances of this bank rose by 2.9 millions, so that the total of all acceptances by the "Big Five" only *fell* by £.8 millions, though one of the group lost over four millions between 1917 and 1918. The London Joint City & Midland also rose £1,000,000. The rise in the percentage is due to a great decline in the aggregate acceptances whilst those of the "Big Five" were comparatively steady.

The net conclusion to which one is forced is that as compared with the pre-consolidation era of 1913, no great change in the situation on the quantitative side has been brought out; though the qualitative factors cannot be over-

stressed. In Table IV below are given items for the "Big Five" as a whole, for the years 1913 to 1918 inclusive. The figures are compiled from the annual banking numbers of the *Economist*.

TABLE IV

THE "BIG FIVE" AS A WHOLE

(Million £'s)

Group	Capital and Reserves	De-posits	Accept-ances	Cash in hand and Call Money	Invest-ments	Discounts and Advances
			1913			
Lloyds	12.91	160.88	10.30	44.03	22.62	107.77
London Joint City and Midland	14.03	149.73	9.48	45.80	17.18	98.55
Barclay's	12.79	119.52	1.70	35.69	22.25	74.31
London County and Westminsier	14.16	151.30	13.76	45.77	21.00	98.49
National Provincial and Union	10.32	115.54	5.95	33.33	19.66	70.48
Total	64.21	695.97	41.19	204.62	102.71	446.60
			1914			
Lloyds	13.06	176.67	9.12	53.23	24.97	109.03
London Joint City and Midland	13.83	173.02	10.36	57.24	21.59	106.07
Barclay's	12.71	128.28	2.24	39.80	26.86	75.53
London County and Westminster	14.04	168.13	8.12	51.28	28.47	102.50
National Provincial and Union	10.34	127.49	4.53	35.90	22.34	77.12
Total	63.98	773.59	34.37	237.45	124.23	470.26
			1915			
Lloyds	12.96	199.35	11.31	57.77	59.12	92.23
London Joint City and Midland	13.83	198.39	11.75	50.02	54.59	104.51
Barclày's	12.71	139.80	4.62	49.57	44.44	66.99
London County and Westminster	13.78	178.42	10.64	47.97	60.14	84.58
National Provincial and Union	10.35	135.52	6.98	29.18	49.77	64.38
Total	63.63	850.48	45.30	234.52	268.06	412.69

Group	Capital and Reserves	Deposits	Acceptances	Cash in hand and Call Money	Investments	Discounts and Advances
	1916					
Lloyds	12.86	227.63	13.83	69.26	64.96	104.36
London Joint City and Midland	13.85	231.80	11.23	71.45	52.19	120.75
Barclay's	12.34	168.75	4.47	55.98	40.46	84.25
London County and Westminster	13.78	197.86	16.35	70.48	60.72	82.20
National Provincial and Union	10.16	164.34	7.43	47.82	57.97	66.11
Total	62.97	990.38	53.31	314.99	276.30	457.67
	1917					
Lloyds	13.36	261.73	12.92	71.70	60.18	142.17
London Joint City and Midland	14.78	288.00	12.01	91.30	71.36	139.54
Barclay's	12.49	204.12	4.51	63.18	39.23	112.39
London County and Westminster	15.15	234.05	14.13	90.59	60.77	98.99
National Provincial and Union	10.47	186.33	3.93	55.47	58.82	80.17
Total	66.25	1174.23	47.50	372.24	290.36	575.26
	1918					
Lloyds	19.85	297.40	15.89	73.79	71.44	172.42
London Joint City and Midland	15.35	346.85	13.23	137.78	65.24	158.94
Barclay's	14.16	239.66	4.21	79.78	50.56	126.30
London County and Westminster	15.46	281.04	9.45	87.76	60.51	148.32
National Provincial and Union	10.33	200.86	3.89	46.80	44.93	117.36
Total	75.15	1365.81	46.67	425.81	292.68	723.34

VII. STATISTICAL TABLES RELATING TO BRITISH BANKING DURING THE WAR

The basis of the following tables are the annual banking numbers of the *Economist*.

The tables have been drawn up for the purpose of ex-

amining what changes have been introduced into the volume and value of British banking as a result of the European war. A double set of ratios have been employed:

(1) the ratio of each kind of asset or liability to the gross assets or liabilities.
(2) the ratio of various kinds of liabilities or assets to one another.

It will be obvious that these two sets of ratios will tend to confirm one another. For if e. g. Discounts and Advances form a smaller part of the total assets than they did before and Investments a larger portion: the ratio of these two items to one another must undergo a similar change.

(a) *Data on British Banking as a Whole*

There is given below, in Table V, the aggregate balance sheet of the banks of the United Kingdom. This excludes the Bank of England and includes the private banks of England and Wales only. The other private banks are relatively unimportant, so that the statement is quite representative of British banking.

The interpretation of these items is not without statistical difficulties owing to lack of uniformity in the definition of items. This is particularly true of the items of Discounts and Advances and Investments. Owing to consolidation, the practice has in at least one case led to the inclusion of Treasury bills among the discounts, whereas they were formerly included among the investments. The result is seen in a sharp fall in the ratio of Capital and Reserve to Investments and a rise in the ratio of Investments to Deposits and Acceptances in the year 1918 in the case of the joint stock banks of England and Wales (Table VI, cols. 15 and 16), though other causes are also at work (sharp increase of Capital and Reserve in 1918; sharp in-

TABLE V. 1. AGGREGATE BALANCE SHEET

BANKS OF THE UNITED KINGDOM (EXCLUSIVE OF BANK OF ENGLAND). INCLUSIVE OF PRIVATE BANKS OF ENGLAND AND WALES ONLY

(Million £'s)

	1913	1914	1915	1916	1917	1918
Capital and Reserves	114.08	113.06	112.13	110.77	114.99	125.05
Undivided Profits	6.45	6.44	6.01	5.96	7.63	7.38
Deposits	1032.99	1135.60	1243.74	1444.43	1705.84	1988.35
Acceptances	67.53	53.96	66.86	75.49	71.13	63.46
Notes, Drafts, etc.	24.99	28.82	36.79	45.21	52.76	63.84
Totals	1246.04	1337.88	1465.53	1681.86	1952.35	2248.08
Cash on Hand and Money at Call	293.56	339.68	330.54	454.22	527.74	611.53
Investments	191.04	225.30	422.00	439.64	463.52	519.76
Discounts and Advances	682.97	701.37	631.58	693.75	873.59	1025.25
Premises and Cover for Acceptances	78.45	71.53	81.41	94.25	87.50	91.52
Totals	1246.04	1337.88	1465.53	1681.86	1952.35	2248.08
Deposits and Acceptances	1100.52	1189.56	1310.60	1519.92	1776.97	2051.81

2. AGGREGATE BALANCE SHEET FOR BANKS OF THE UNITED KINGDOM (EXCLUSIVE OF BANK OF ENGLAND)

Year	Percentage Ratios of														
	Capital and Reserves to Liabilities	Cash and Call Money to Liabilities	Deposits to Liabilities	Acceptances to Liabilities	Deps. & Accs. to Liabilities	Notes & Drafts to Liabilities	Investments to Liabilities	Discounts and Advances to Liabilities	Acceptances to Deposits	Notes to Deposits	Capital and Reserves to Deps. & Accs.	Cash & Call-Mo. to Deps. & Accs.	Investments to Deps. & Accs.	Capital & Res. to Investments	Disc. & Advances to Deps. & Accs.
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	
1913.	9.1	23.6	82.9	5.5	88.4	1.0	15.3	53.8	6.5	2.4	10.4	26.7	17.4	59.7	62.0
1914.	8.4	25.4	84.9	4.0	88.9	2.2	16.8	52.4	4.8	2.6	9.5	28.6	18.9	50.2	59.0
1915.	7.6	22.6	84.9	4.6	89.5	2.6	28.7	42.4	5.4	2.6	9.0	25.2	32.2	26.5	48.2
1916.	6.6	27.0	85.9	4.5	90.4	2.7	26.2	41.3	5.2	3.1	7.3	29.9	28.9	25.2	44.6
1917.	6.0	27.0	87.4	3.6	91.0	2.7	23.8	44.8	4.2	3.1	6.4	29.7	26.1	24.8	49.2
1918.	5.6	27.2	88.9	2.8	91.7	2.8	23.1	45.6	3.1	3.2	6.0	29.8	25.8	24.0	50.0

crease in deposits in 1918). Similarly the ratios of British Government Securities to Other Securities (Table IX) are not without statistical difficulties.

In the treatment of the subject, a good deal of stress is laid on the ratio of various items to Deposits and Acceptances. In the British banking system (and especially in England and Wales) the Deposits are essentially the mobile factor indicating a policy of credit-creation or inflation. Hence, assuming that business loans or temporary loans to government are covered by the items included in Discounts and Advances (collateral of various kinds; trade-bills, grain-warrants, etc. and Treasury bills) whilst long-term loans to the government largely are covered by investments, relative changes in the ratio of these various items to Deposits and Acceptances will tend to show the direction of banking business.

Taking first a broad view of the situation, it will be noted that in the years of the war the gross assets or liabilities have almost doubled, taking the United Kingdom as a whole. Within these less general limits, however, wide differences are to be observed in the various parts of the United Kingdom.

(b) *England and Wales*

The important point in the banking situation in England and Wales is the inverse movement of the Investments and the Discounts and Advances in the middle period. A glance at Table VI will show that between 1913 and 1915 the ratio of the former to Deposits and Acceptances rose, the latter fell. It may seem at first strange that the downward movement of the latter continued in the following years even though the investment ratio was also falling: but this continued fall in the discount and advance ratio thereafter stopped and the ratio rose whilst the investment ratio fell. The rise in Dis-

TABLE VI. JOINT-STOCK BANKS OF ENGLAND AND WALES, EXCLUSIVE OF THE BANK OF ENGLAND.

(Million £'s)

Year	Capital	Reserves	Together	Cash [1]	Call-Money and ShortNotes [1]	Together [1]	Deposits	Acceptances	Together	Investments	Discounts and Advances	Year
1913....	48.47	33.60	82.07	115.49	97.26	235.96	809.35	61.70	871.05	121.24	539.90	1913
1914....	48.22	33.68	81.90	169.52	81.20	276.05	895.56	47.80	943.36	146.49	553.50	1914
1915....	48.53	33.20	81.73	178.92	68.39	262.45	902.56	62.51	1055.07	310.77	503.62	1915
1916....	48.24	32.85	81.09	247.98	95.46	369.46	1154.88	68.73	1023.61	323.00	542.77	1916
1917....	49.28	35.20	84.48	238.50	165.54	427.86	1365.30	65.78	1431.08	339.63	685.68	1917
1918....	49.67	43.23	92.90	270.14	184.57	481.22	1583.41	58.85	1642.26	347.23	834.69	1918

[1] The figures in these three columns are not comparable, owing to the fact that not all Banks issue these items separately. The Economist states that 94½% is distinguishable, but this is only true since 1915; before that the distinguishable portion falls to 90–91%.

Year	Total Assets or Liabilities	Capital and Reserves to Liabilities	Call Money and Cash to Liabilities	Deposits to Liabilities	Acceptances to Liabilities	Deposits and Accs. to Liabilities	Investments to Liabilities	Discounts and Advances to Liabilities	Acceptances to Deposits	Paid-up Capital to Deps. & Acceptances	Cash to Deps. and Acceptances	Call Money to Deps. & Accs.	Cash & Call Money to Deposits & Accs.	Capital and Res. to Deposits & Accs.	Investments to Deps. & Accs.	Capital and Res. to Investments	Paid-up Capital to Investments	Discounts and Advances to Deps. & Accs.
		%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
1913..	963.05	8.5	24.3	84.0	6.4	90.4	12.6	56.0	7.6	5.5	13.2	11.0	27.8	9.6	13.9	67.6	39.6	60.7
1914..	1034.49	7.7	27.6	86.6	4.6	91.2	14.2	53.5	5.1	5.1	17.9	8.6	29.5	8.7	15.5	56.2	32.5	57.6
1915..	1146.81	7.1	22.9	86.4	5.5	91.9	27.0	43.9	6.3	4.6	17.0	6.4	24.8	7.8	29.4	26.5	15.5	47.7
1916..	1319.22	4.2	28.0	87.9	5.2	93.1	24.6	41.4	4.9	4.0	20.3	7.8	30.0	6.6	26.4	25.1	14.9	44.4
1917..	1628.63	5.5	28.0	89.2	4.3	93.5	22.2	44.9	4.8	3.4	16.7	11.6	29.8	5.9	25.8	24.8	14.5	47.8
1918..	1742.72.	5.3	27.6	90.9	3.4	94.3	20.0	47.9	3.6	3.2	16.4	11.5	29.3	5.6	21.9	26.8	14.3	50.9

[1] See Note above. As the distinguishable portions only could be used, the percentages in the text are therefore somewhat of an understatement.

counts and Advances and the fall in Investments was partly due to statistical changes, but also due to the policy of continuous borrowing and the consequent avoidance of the policy of spectacular loans and the sharp rise in the holding of securities which took place in 1915. The increased cash-holdings are to be associated with the policy of the Bank of England in paying interest on bankers' money and with the facility with which the note policy of the government enabled the banks to acquire notes; a process fully explained by the Committee on Currency and Foreign Exchanges.[1]

(c) *Scotland and Ireland*

There are some significant differences between both Scotch and Irish banks and the banks of England and Wales, and between one another.

(1) As regards the first point, it is to be noted particularly:

(a) That in both Scotland and Ireland, after a period of decline in 1916 and 1917, the investment ratio rose again in 1918.[2]

(b) That (owing no doubt to the rise in the note issue) there had been less of an advance in the deposit-liabilities ratio than in England and Wales.

(2) As regards the second point, the significant fact is the great rise in both Cash and Call money and Note ratios in Ireland, that this rise is associated with a steady fall in the ratio of Discounts-Advances to Deposit-Acceptances (note 1916-1917). As a conjecture, is this to be associated with great material prosperity in Ireland plus a disturbed political situation leading to notes of Irish banks being hoarded?

In all three Counties, the ratio of Capital and Reserves to Liabilities and other elements fell.

[1] Cd. 9182 of 1918, p. 4, note 2.

[2] We must again refer to the fact that in England and Wales we *know* that there have been alterations in the statistical basis.

TABLE VII. JOINT-STOCK BANKS OF SCOTLAND

(Million £'s)

Year	Capital	Reserve	Together	Cash & Call-Money	Deposits	Acceptances	Together	Notes	Investments	Disc. and Advances
1913......	9.24	8.06	17.30	33.96	125.89	5.46	131.35	7.74	38.06	77.76
1914......	9.24	7.44	16.68	34.60	132.50	5.68	131.18	9.50	44.82	78.36
1915......	9.24	6.96	16.20	35.73	140.57	4.00	144.57	12.56	67.02	64.62
1916......	9.24	6.41	15.65	42.03	166.62	5.92	172.54	15.46	69.69	85.14
1917......	9.23	6.84	16.07	47.79	196.54	4.50	201.04	19.02	71.58	112.16
1918......	9.23	7.35	16.58	57.25	222.06	4.08	226.14	25.14	93.89	113.96

Year	Total Assets to Liabilities	Cap. & Res. to Liabilities	Cash & Call Money to Liabilities	Deposits to Liabilities	Accs. to Liabilities	Deps. & Accs. to Liabilities	Notes & Drafts to Liabilities	Investments to Liabilities	Disc. & Advs. to Liabilities	Accs. to Deposits	Notes to Deposits	Cap. & Res. to Deps. & Accs.	Cash & Ca. Mo. to Deps. & Accs.	Investments to Deps. & Accs.	Cap. & Res. to Investments	Disc. & Advs. to Deps. & Accs.
		%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
1913......	159.80	10.8	21.3	78.8	3.1	81.9	4.8	23.9	48.7	4.8	6.2	13.0	25.9	29.0	44.7	58.5
1914......	167.84	10.0	20.6	79.0	3.6	82.6	5.7	26.8	46.7	4.5	7.2	12.7	26.4	34.2	27.3	60.0
1915......	177.00	9.1	20.7	82.0	2.3	84.3	7.1	37.9	46.5	2.8	8.9	11.2	25.2	46.5	24.2	44.6
1916......	207.38	7.5	20.3	80.2	2.9	83.1	7.5	33.5	41.1	3.6	9.3	9.1	24.4	40.5	22.5	49.1
1917......	240.55	6.7	19.8	81.7	2.1	83.8	7.9	29.6	46.5	2.5	9.7	8.0	23.8	35.6	22.4	55.7
1918......	273.66	6.8	20.9	81.1	1.5	82.6	9.2	34.3	41.6	1.8	11.2	7.4	29.2	41.6	17.7	50.0

TABLE VIII. JOINT-STOCK BANKS OF IRELAND

Year	Capital	Reserves	Together	Cash and Call Money	Deposits	Accept'es	Together	Notes	Investments	Discounts and Advances
1913......	7.31	3.79	11.10	17.9	70.66	.36	71.04	8.07	23.94	48.60
1914......	7.31	8.89	11.20	22.38	73.50	.47	74.97	10.92	25.97	48.15
1915......	7.31	3.70	11.01	23.31	77.72	.36	78.08	15.00	35.33	44.71
1916......	7.31	3.54	10.85	32.55	83.75	.85	84.60	19.11	38.15	42.97
1917......	7.31	3.95	11.26	40.09	99.31	.86	101.17	22.34	42.11	50.62
1918......	7.31	4.53	11.84	56.81	131.61	.53	132.14	30.90	65.31	51.99

Year	Total Assets or Liabilities	Cap. & Res. to Liabilities	Cash & Ca.-Mo. to Liabilities	Deposits to Liabilities	Accepts. to Liabilities	Deps. & Accs. to Liabilities	Notes to Liabilities	Investments to Liabilities	Discs. & Advs. to Liabilities	Acceptances to Deposits	Notes to Deposits	Cap. & Res. to Deps. & Accs.	Cash & Call Money to Deps. & Accs.	Investments to Deps. & Accs.	Cap. & Res. to Investments	Discounts & Advances to Deps. & Accs.
		%	%	%	%	%	%	%	%	%	%	%	%	%	%	%
1913......	90.91	12.2	18.0	77.9	.4	78.3	8.9	26.3	53.5	.5	11.4	15.5	24.0	33.8	46.4	68.5
1914......	97.81	11.5	22.9	76.3	.5	76.8	11.2	26.6	49.9	.6	14.6	14.7	29.3	34.6	43.2	64.0
1915......	104.80	10.5	22.2	74.0	.3	74.3	14.3	33.6	42.6	.5	19.3	14.1	30.0	44.9	31.4	57.7
1916......	115.21	9.4	28.3	72.8	.7	73.5	16.6	33.2	37.2	1.0	22.9	12.8	38.4	44.7	28.1	50.7
1917......	134.52	8.4	29.8	73.8	.6	74.4	16.6	31.4	37.5	.9	22.2	10.9	39.6	41.6	26.2	50.9
1918......	175.74	6.7	31.8	74.9	.3	75.2	17.6	37.2	29.6	.4	23.2	9.0	43.2	49.2	18.1	39.4

How very largely the financial difficulties of the government dominated the situation may best be seen from Tables IX and X. Making a large allowance for the statistical aspects of the matter, which certainly exaggerated the changes, the fact remains that (1) the ratio of Discounts to Advances, that is, the proportion of loans secured by bills and not by other collateral, showed a remarkable change between 1913 and 1918; whilst for every £100 of advances in 1913 there were £19 of discounts, in 1918 there were £60 of discounts. These figures are subject, it must again be urged, to a considerable margin of error, but it is clear from other considerations that government financing must have played a large role. The volume of bank acceptances had fallen off during the war and it is notorious that at times the bill market was very short of bills. The change must be associated, therefore, largely with the increased holding of Treasury bills by the banks. (2) The ratio of Other Securities to British Government Securities fell greatly after 1914. The fall was sharpest in 1915; the year in which the greatest pressure was placed on the banks to assist the government in the taking up of War Loan. Here again the figures are largely illustrative, owing to non-uniformity of practice. The several security mobilization schemes of the government described in the first chapter undoubtedly had an effect in reducing the Other Securities held by the banks.

The functions performed by the joint-stock banks in financing the war have been outlined in the present chapter, which shows how completely the banks were taken into the system of national credit creation and control organized around the Bank of England, but directed and in effect operated by the Treasury as a war industry. Deposits were expanded on an unprecedented scale and irredeemable currency notes supplied as needed for "reserve". As has been pointed out, the Bank of England was the *instrument* for

TABLE IX

BRITISH GOVERNMENT AND OTHER SECURITIES HELD BY JOINT-STOCK BANKS

Year	British Government Securities (£ Million)				Other Securities (£ Million)				Ratio of other Securities to British Government Securities %			
	England and Wales	Scotland	Ireland	United Kingdom	England and Wales	Scotland	Ireland	United Kingdom	England and Wales	Scotland	Ireland	United Kingdom
1913...	79.45	10.10	8.57	98.12	41.79	27.95	15.37	85.11	52.4	280.0	178.0	86.8
1914...	72.44	14.13	10.25	95.82	75.05	30.69	15.72	121.46	105.7	221.4	152.4	127.3
1915...	436.76	35.84	20.15	292.75	74.01	31.18	15.18	120.37	31.3	89.0	75.0	40.6
1916...	258.54	47.02	26.36	331.92	64.46	22.57	11.79	98.92	24.6	48.9	46.2	30.0
1917...	279.54	52.02	30.88	362.44	60.09	19.56	11.23	90.88	21.4	38.5	35.5	25.1
1918...	282.84	69.54	54.20	406.58	64.39	24.35	11.11	99.85	22.7	37.5	20.4	24.6

currency and credit dilution, but it was in the banks that expansion, for the most part, took place. Changes in the items of the banks' statements which war financing brought about are shown in the statistical tables, which illustrate the great increase of government paper in the assets of the banks of the United Kingdom as a whole.

The war stimulated the bank amalgamation movement, partly as an aid to war financing and partly as a preparation for the trade struggle expected in the post-war years. This movement awakened some apprehension in Great Britain because of the fear that it might result in a banking monopoly through the interlocking of directorates in a small number of large institutions. However, the fears regarding the ill effects of widespread consolidation seem in retrospect to have had little real basis.

The new banking companies organized during the war marked a tendency in the direction of the German method of closer relationship between industry and banking—a tendency

TABLE X

DISCOUNTS AND ADVANCES: JOINT STOCK BANKS[1]

Year	Discounts (£ million)				Advances (£million)				Ratio of Discounts to Advances %			
	England and Wales	Scotland	Ireland	United Kingdom	England and Wales	Scotland	Ireland	United Kingdom	England and Wales	Scotland	Ireland	United Kingdom
1913...	92.41	18.05	5.10	115.58	499.50	59.72	43.50	602.75	20.4	30.0	11.6	19.2
1914...	88.38	15.33	5.34	109.05	465.12	63.03	42.81	570.96	18.9	23.8	11.6	19.1
1915...	62.81	11.76	5.06	79.63	440.81	52.86	39.64	533.31	14.1	22.6	12.8	13.0
1916...	119.36	29.61	4.07	153.04	423.41	55.54	58.90	517.85	28.2	53.6	10.0	29.5
1917...	183.05	47.31	4.38	234.74	502.62	64.65	46.24	613.71	36.5	72.3	8.7	38.3
1918...	307.31	53.61	4.80	375.72	527.36	50.35	47.19	624.90	58.2	126.0	10.2	60.3

to develop increased, comprehensive banking "service" to business. This tendency, however, has not grown noticeably in the British banking system as a whole during the post-war period. Nevertheless, one development has remained as a definite outcome of the war, and that is the greatly increased activity of the joint-stock banks in foreign trade financing. Before the war the joint-stock banks did only about 10% of the acceptance business of London, whereas they are now doing from 30% to 35%, with every indication of a continued percentage increase. In general, however, British banking method has been little changed by the war.

The next chapter will discuss the functioning of the money

[1] It will be understood that these figures are subject to a considerable margin of error owing to the fact that some banks do not distinguish between Discounts and Advances: whilst others include Treasury bills—properly a "discount"—among their holdings of British Government Securities.

vide *Economist* Banking No. for May 17, 1919, p. 820. "The Nalional Provincial, Parr's, Capital and Counties and London and Provincial did not show the items separately, but this year, owing to amalgamations, the figures of all these banks are included among those which distinguish them . . . The increase shown . . . is therefore largely artificial."

market as a whole during the war, and thus round out the picture of the complete financial machinery for war financing, consisting of the Bank of England, the joint-stock banks, and those other groups of institutions which are a most important part of the market machinery.

CHAPTER VI

The Money Market

I. DESCRIPTION OF INSTITUTIONS

The London money market is a well-organized group of institutions each of which plays a vital part in the functioning of London as a world financial center. This group consists of the Bank of England; the deposit banks, both joint-stock and private; the acceptance houses; the discount houses, that is, dealers in commercial bills; and the bill brokers. The functions of the bill brokers and the discount houses are practically the same, except that the discount houses buy bills and hold them on their own account, whereas the bill brokers, often called "running brokers," act purely as agents between the banks and discount houses.

The Bank of England and the joint-stock banks have been described in separate chapters. A description of acceptance houses, discount houses and bill brokers will now be given, and their function in relation to the money market during the war outlined.

(a) *The Acceptance Houses*

The acceptance houses, often called merchant bankers, are old-established private firms with connections all over the world. As part of their commercial activity, they instituted many years ago the practice of accepting for their clients bills drawn against the shipment of goods. These institutions have played a rôle of very great importance not only in the development of British trade but also in the development of London as a financial center. The joint-stock banks have until recently been essentially deposit banks and though

they have played their part in the financing of British foreign trade, by far the more important part has been played by the acceptance houses. Even the foreign banks with branches in London have played a less important rôle. The acceptance houses have possessed a knowledge of their clients in foreign fields which makes them competent to pass on the credit of shippers in every part of the globe. So great has been their prestige in this regard that their paper has consistently enjoyed a preferential rate over that of the joint-stock and foreign banks. There are seventy-five or eighty of these acceptance houses in London. Some of the best known are the following:

Fruhling & Goschen	Konig Brothers & Co.
Antony Gibbs & Sons	Lazard Brothers & Co.
Baring Brothers & Co.	N. M. Rothschild & Sons
C. J. Hambro & Son	Seligman Brothers
Frederick Huth & Co.	Samuel & Co.

There has been criticism, from time to time, of the preferential position which the acceptance houses have enjoyed in the London money market. They are private firms and consequently are not required to make any public statement of their balance sheets.[1] The agencies of large foreign banks have complained that their paper is discriminated against in the matter of rates in the market and at the Bank of England, without warrant. The plea has been that these agency banks have assets far in excess of most of the acceptance houses and that the public knows and can always verify the condition of their books. In an article by Mr. R. C. Wyse, then Manager of the Guaranty Trust Company of New York,[2] a plea was made for the removal of dis-

[1] Baring Brothers & Co., are an exception to this, being a limited company.

[2] "The Future of London as the World's Money Market," R. C. Wyse, *Economic Journal*, December, 1918.

crimination against the paper of the foreign banks at the Bank of England and in the money market, and the argument was made by him that London cannot remain a center for the financing of inter-foreign trade unless the paper of agency banks is given the same treatment as that of the acceptance houses. Mr. Wyse said: "If London is to resume its supremacy as the financial center of the world, there should be no restrictions on the legitimate operations of foreign banks which are entitled to their proper share in the world's money market. You cannot have a world's money market located in London unless the foreign banks are allowed to have their rightful status in such a market. The money market of the world is essentially a cosmopolitan thing."

(b) *The Discount Houses*

The discount houses are dealers in commercial paper. They buy and sell it for a profit. They are essentially middlemen between the producer and the consumer, so to speak, of commercial bills. They have evolved from brokers who handle bills on a commission basis. The discount houses hold bills on their own account, and it is to them that the seekers after bills usually go. They are likewise the principal purchasers of bills. The joint-stock banks are, of course, large holders of bills which they use as a secondary reserve. They are not normally sellers of bills unless the condition of their reserves warrants it. They buy in volume and hold for maturity. The discount houses are essentially dealers in bills and are prepared to buy or sell as the condition of money rates gives promise of a profit. These institutions have evolved to a point where they now compete to a degree with the joint-stock banks, for they seek time deposits though they do not carry on the other functions of a bank. They are heavy borrowers from the joint-stock

banks, however, of "day to day" money, with which they trade in bills. This "day to day" money is what is called in America call money. More will be said regarding call money later in this chapter. There are seventeen discount and credit companies listed in the London Banking Almanac for 1919. These are limited companies and some of them have liabilities exceeding thirty million pounds. There are in addition to the discount companies a number of discount agents who deal in bills but are not of the same importance. A table of the balance sheets of the three chief discount companies which regularly publish their statements is given on p. 268. This includes their balance sheets for the years 1914-1919 inclusive and indicates their development and prosperity during the war period.

(c) *The Bill Brokers*

The bill brokers as a rule specialize in particular types of paper and call only on the institutions interested in their own line of merchandise. One broker will handle Indian paper entirely and daily canvass the Indian branch banks and acceptance houses doing business in India to determine what they have to sell. On the other hand, he will call upon the joint-stock banks or other institutions with which he has established connections, and endeavor to meet their demands as to types of paper and maturities. The question of maturities is a very important one to the large banks, as they regulate the maturities of their assets from the standpoint of the needs of their reserves. When the end of the year comes and the "window dressing" season is on, the question of maturities has a very substantial bearing on the condition of the balance sheet. It can thus be seen that the broker performs a very significant function and is of vital importance to the banks. The banks do not wish to have their requirements in regard to bills known to other banks

Balance Sheets of the Chief Discount Companies

(Million £s)

		Liabilities						Total Liabilities or Assets	Assets							
		Capital and Reserves	%	Loans, Discounts and Other Accounts	%	Bills Rediscounted	%		Cash at Bankers	%	Investments	%	Bills Discounted	%	Loans and Sundry Accounts	%
1914..	Alexander's	.62	5.9	9.43	90.3	.28	2.7	10.44	.35	3.4	1.34	12.8	8.68	83.1	.07	0.7
	National	1.35	8.0	13.01	77.0	2.29	13.5	16.90	.43	2.5	1.85	11.0	13.69	81.1	.76	4.5
	Union	1.76	8.2	16.22	75.4	3.11	14.6	21.48	.92	4.3	2.79	13.0	16.63	77.4	.98	4.6
1915..	Alexander's	.62	5.9	9.44	90.3	.27	2.6	10.46	.37	3.5	1.14	10.9	8.89	85.0	.06	0.6
	National	1.35	7.9	11.67	68.7	3.71	21.6	17.03	.46	2.7	1.38	8.1	14.70	86.4	.33	1.9
	Union	1.76	7.3	17.84	73.7	4.16	17.2	24.18	.97	4.0	2.18	9.0	20.29	83.9	.58	2 4
1916..	Alexander's	.64	5.0	10.98	84.9	1.15	8.9	12.92	.39	3.0	1.67	12.9	10.86	84.1	.00	.0
	National	1.30	5.0	16.78	64.9	7.36	28.6	25.83	.49	1.9	1.04	4.0	22.10	85.6	1.96	7.6
	Union	1.77	6.7	19.26	73.3	4.77	18.1	26.29	1.04	4.0	1.98	7.5	22.30	84.8	.81	3.1
1917..	Alexander's	.67	4.5	12.67	85.2	1.35	9.0	14.87	.41	2.7	1.79	12.0	12.62	84.9	.05	0.4
	National	1.30	4.0	21.14	65.0	9.60	29.5	32.52	.65	2.0	1.15	3.5	28.00	86.1	2.39	7.4
	Union	1.80	6.0	23.34	77.5	4.45	14.8	30.09	1.04	3.5	2.66	8.8	25.87	86.0	.36	1.2
1918..	Alexander's	.70	4.2	13.83	83.3	1.91	11.5	16.62	.42	2.5	2.24	13.4	13.80	83.1	.17	1.0
	National	1.35	4.8	17.97	63.9	8.38	29.8	28.12	.52	1.8	2.37	8.4	23.49	83.6	1.45	5.2
	Union	1.83	5.3	27.58	79.6	4.82	13.9	34.64	1.07	3.1	4.25	12.3	26.66	76.9	2.49	7.2
1919..	Alexander's	.72	3.9	16.18	88.8	1.34	7.4	18.22	.42	2.3	1.35	7.4	16.35	89.7	.10	0.6
	National	1.35	4.0	23.99	71.0	9.15	27.1	33.79	.58	1.7	1.47	4.4	29.82	88.3	1.91	5.7
	Union	2.13	5.3	31.25	77.8	6.72	16.7	40.18	1.17	2.9	3.80	9.4	33.69	83.9	4.52	11 2

nor do they wish them to know too much of the type of paper they are buying. Moreover, it is easy for banks when dealing through a broker, to discriminate against the names of firms whose paper they do not like or of whose bills they consider they have a sufficient amount in their portfolios.

These institutions round out the money market. The money market in this sense of the term is often called the discount market. The discount market is literally the market where commercial bills are bought and sold. The bulk of the bills bought and sold in the discount market enters Great Britain from other countries. "At every foreign center," says Mr. W. F. Spalding,[1] "there are always merchants ready to export their wares, and it naturally follows that the funds the bankers receive abroad by the encashment of the drafts sent from London will be utilized for purchasing bills offered by exporters at the foreign cities. The exporters obtain payment for their produce by drawing on London in the same way as the shippers here draw on foreign countries, and the net result of the two operations is the influx of bills into England for ultimate circulation on the London discount market."

II. FINANCING DOMESTIC TRADE

The use of the acceptance to finance domestic trade, though quite general 30 or 35 years ago, has been practically discontinued. Domestic trade acceptances are at times taken by the banks from their clients, particularly in the provinces, but the domestic acceptance as such is not a factor in the London discount market. To the small extent that they are taken by the banks, they are held for maturity. The accredited method of financing domestic trade is by bank advances which take the form either of overdrafts or the discounting of the client's note.

[1] *Foreign Exchange and Foreign Bills*, W. F. Spalding, Sir Isaac Pitman & Sons, Ltd., London, 1915.

The five large joint-stock banks, which have branches throughout the United Kingdom and control over 75% of the banking business of the country, use the overdraft very extensively. The overdraft is used particularly in the case of the very large firms, and more generally in the provinces than in London. It does not follow, of course, that advances made in this form are unsecured. The custom is to keep with the bank as a reserve against which to secure advances a certain amount of securities — this being true whether the advance is to be an overdraft or a loan. To obtain an overdraft the firm calls on or writes the bank and advises it that it wishes to overdraw its account for a prescribed amount, and the bank if agreeable then honors checks against it for approximately that amount. The sum is never rigid and the extent of the overdraft is left to the requirements of the firm. There is given below a sample form such as the client is required to fill out and sign giving the bank control over the securities on deposit.

Security on Stocks and Shares

London, 19——

(Name of Bank)

request you to advance to .... the sum of £ .... on the Securities specified in the annexed Schedule, of the present value of £ ...., which advance .... undertake to repay on or before the .... with interest thereon, at the rate of £ .... percent, per annum, and undertake at all times to maintain, without notice from you, a margin of .... in the value of the Securities over the advances.

The above Securities, and all other Securities of any class from time to time lodged with you by .... or on ...... account, shall remain as a security for payment to you not only of the above advance and interest, but also of all moneys (including interest and expenses) from time to time owing by

. . . . or for which . . . . may be liable to you on any account whatever either alone or jointly with any other person or persons. And in default of payment of any such money when due and for reïmbursement thereof you are hereby authorized to sell such Securities or any of them, without notice, in any way deemed expedient.

The Security hereby given shall extend to all Securities of and Moneys owing by all or any persons or person from time to time carrying on business in partnership with or under the name of the undersigned.

(Stamp, 6d.)

SCHEDULE

Some banks follow the practice of having borrowers on overdrafts sign their account as an acknowledgment, and this has the legal status of a note. It is always necessary for a firm requesting permission to overdraw to state when it expects to be able to make payment, but large firms have heavy overdrafts almost continuously. The manager of one of the big joint-stock banks when questioned said it was hard to estimate what percentage of his bank's advances were in the form of overdrafts but that he thought perhaps one-fifth in the number of loans, but more than this in the volume of credit extended, because of the fact that the overdraft is used most by the big firms.

Aside from the use of the overdraft, the manner of financing domestic trade is similar to that which prevails in the United States. Advances are made for sixty or ninety days on the note of the borrower, usually with, but sometimes without, collateral security, the discretion of the bank in the matter of making advances being the main source of safety where securities are not taken. However, it is the buyer of the goods that seeks the accommodation at the bank rather than the seller. The abuses of the "open book account" system, with the wholesaler or manufacturer financing his

customer, do not exist. The bank finances the transaction directly when financing is necessary. The banker makes no real distinction in his mind between advances made on the note of his client and the overdraft, since the latter is as much secured as the note.

III. THE DETERMINATION OF MONEY RATES

(a) *The Bank Rate and the Market Rate*

On September 26, 1919, the Bank of England rate, ordinarily called the "Bank Rate," was 5%; the market rate for three months' bills was 3–9/16%; the call money rate, 3%. There is normally two points' difference between the Bank rate and the call money rate, and the market rate is normally between the two. The Bank of England, therefore, is the final though not the usual place for the discount of commercial bills. The discount rate is the price of the bills in the market which is determined by the demand for and supply of funds, the normal supply of funds being the surplus deposits of the joint-stock banks, that is, the "day to day" or call money. The reserves of the Bank of England are the source of supply of money when conditions are abnormal and the scarcity of funds in the market forces the holders of bills to rediscount at the Bank of England. The joint-stock banks, especially the large ones, disdain to use the discount facilities of the Bank of England [1] and depend almost entirely on their own cash reserves. When the market tightens, the joint-stock banks restrict their lendings to the discount houses, and put up their rates. If the tightening is sufficiently severe, the discount houses may be forced to go to the Bank and pay the Bank Rate for accommodation, that is, to get funds from the Bank to repay the joint-

[1] In times of great crisis they are forced to do so. At the outbreak of the war all but one of the "Big Five" had to go to the Bank of England for assistance.

stock banks their "day to day" advances. The Bank of England, therefore, in normal times, controls the money market by its charge for accommodation under scarcity conditions. Under ordinary conditions in recent years just preceding the war, however, the Bank frequently had to go into the market and create an artificial scarcity in order to make its rate effective. This was a natural outcome of the development of the power and resources of the joint-stock banks. The method by which the Bank Rate controlled the market has been described in the chapter on the Bank of England.

(b) *Call Money*

Call money, as has been said, is the normal source of supply for the discount market. Lowness and stability of call money rates are therefore vital to the proper functioning of the London discount market and the successful financing of foreign trade. Call money in New York is largely taken by the stock brokerage houses for the financing of speculation in stock market securities, and fluctuations in the rates of call money are therefore determined largely by the relation of surplus bank deposits to the demand for stock market funds. The fluctuations of the stock market may be intense and precipitous. The fluctuations of trade are relatively gradual and slow in their movement. The supply and demand factors relating to call money are, therefore, quite different in New York and London. An examination of the chart opposite page 279 showing money rates in London during the war period will indicate how steady was the condition of call money rates. This, it is true, was due partly to Treasury control, but a prewar period would show much the same condition. The price of call money has consistently been almost as steady as the bank rate. A similar chart of the New York money market for almost any

given period would show a far different picture. It is quite evident that the domination of the New York call money market by the stock brokerage houses is a serious obstacle to the progress of New York in becoming a great center for the financing of world trade. If a broad discount market is to be established in America, it is not only necessary to stimulate the development which has been going on during the last few years under Federal Reserve control, of standardizing commercial paper and making this the principal secondary reserve of the banks, but it is also necessary to modify the present arrangement of daily settlement in the Stock Exchange. With this must come a change of policy on the part of the banks in the matter of lending money for stock-exchange purposes. If we wish to finance the world's trade in the way that Great Britain has done in the past, we must divert our funds from speculative into trade channels. In order that the relation of call money to the investment market in London may be understood, a brief description of the London Stock Exchange is advisable.

(c) *The London Stock Exchange*

Practically all business on the London Exchange is done "for the settlement," which takes place once each month for certain British Government securities, and twice each month for all others. The exchange of money and securities does not actually take place until then, and the sale is in effect a contract for a future date, namely, the next settlement day. Therefore, consideration of the time which will intervene before he receives his money of course has its effect on the price at which the holder of the securities will sell. In the event of a dividend day intervening between the date of sale and the next settlement day the security may be sold with dividend or without. Also, in exceptional cases where the buyer is willing to pay cash immediately and

wants his securities at once, immediate delivery can be arranged.

The peculiarity of the periodical settlement days to the American mind lies more, however, in the arrangements by which a buyer may have his securities "carried over" for him from one settlement day to the next or to any future settlement, if unable to pay for them at the first settlement. He arranges with some broker or jobber to find the money to pay the original holder and to accept the securities for him, and at the same time enters into an agreement with the jobber or broker to buy the securities back at the next or some other settlement day. The price at which the jobber or broker agrees to sell back the securities is the "making up" price of the settlement in question, this price being the average market price of the security at 11:30 o'clock in the morning of the two days preceding the settlement, and being officially determined and announced by a stock exchange committee. It is a technical sale to the jobber, and the final sale to the buyer is a third sale. Of course the jobber requires the buyer to put up a margin to protect himself in case of a fall in the price of the security, and unless his client's solvency is well known to him requires the maintenance of the margin at the original amount. The broker may sell the security on the market if the buyer fails to do this. For carrying the security the broker charges the buyer an interest rate, or "contango," on the money he supplies. This is not an official figure, and is arrived at by private agreement in each case, but is invariably about ½% above the market rate for call money. Brokers and jobbers will undertake no business for unknown clients. The American readiness to do business for anyone who can produce a reasonable margin has never characterized British practice.

It should be noted that the method of deferred delivery makes speculation on the London exchange a speculation in

movements between the day of sale and the next settlement, or from one settlement to another, instead of from day to day, as in Wall Street. Moreover, the volume of business done on an exchange where the contango method prevails is in appearance much greater than on an exchange which does not make use of this method. This is due to the fact that a single carry-over gives rise to three sales; the holder's to the buyer, the buyer's to the broker, and the broker's back to the buyer, all of which are included in the total of business done.

Various restrictions were enforced by the Treasury on the Stock Exchange when it was allowed to resume business after its four months' suspension following the outbreak of the war. Among these, the settlements were abolished, and it was required that all dealings should be for cash, that deliveries of bearer securities should take place the day following the sale, and that all transactions should actually be completed within five days after the sale. At the request of the Treasury, the Stock Exchange also prohibited dealings in any new issues until they had been approved by the Treasury, and each individual broker or brokerage firm was expected to obtain permission from the Treasury before he might deal in any new issue on the floor of the Exchange. This restriction did not have the force of law, and a number of new capital issues were brought out in defiance of the Treasury's wishes by brokers who were not members of the Exchange.

The restrictions on the floating of new issues and on the export of capital from the country were relaxed early in 1919 and the Stock Exchange had some very busy months. Subsequently, all restrictions were removed and the Stock Exchange resumed its normal functioning.[1]

[1] For further particulars regarding governmental control of the Stock Exchange see Chapter I, p. 19.

The prohibition of settlement days and dealing on margin during the war did not, of course, do away with speculation, for it did not prevent a broker or banker from supplying a client in the form of a loan with part of the money to buy securities, and taking the securities themselves as collateral. It had, however, a very markedly repressive effect on such speculation. Most of the capital which brokers did use in buying on margin for their customers was supplied by the banks, which, following the wishes of the Treasury, were very reluctant to lend money for such purposes. The amount of banks' call money lent on stock exchange securities, which before the war was somewhat more than a hundred million pounds, was during the war less than a fifth of that amount, and as the brokers had little capital of their own they were forced to reduce this form of their business greatly.

IV. THE MONEY MARKET DURING THE WAR

(a) *Complete Government Control*

As has been pointed out in other chapters, there was developed during the progress of the war complete government control of the money market, which began to be gradually relaxed only a year after the Armistice. Heavy government war purchases abroad, particularly in the United States, depreciated sterling exchange; and even if there had been gold sufficient to pay the adverse balance with the United States, it could not have been shipped uninterruptedly because of the dangers of capture or submarine attack. Early in the war, therefore, Great Britain became financially isolated and the normal power of Bank control over rates could not be exercised. The Bank's machinery of control described above therefore disappeared. On the other hand, the monetary requirements for carrying on the war were of first importance and the whole financial system had to lend itself to this purpose. Money rates, therefore, were made what the

government wished them to be without any reference to the question of world rates for money, which under the abnormal world conditions could not have been determined even had the government wished to do so. The Government's position, particularly as the increased concentration of the nation's effort on warfare cut off normal commerce, became that of the almost exclusive user of market funds. In other words, there was little competition with the government for money; and the various controls of capital issue, etc., helped to insure the government's monopoly.

(b) *Treasury Bills*

Treasury bills rapidly took the place of commercial bills in the discount market. As has been described in the chapter on government borrowings, the rate at which the bills were sold was determined by the Treasury. Consequently, the rate for money was also determined by the Treasury. In view of the arrangements made for giving the banks practically as much currency as they desired, there could be no scarcity of "funds," and the necessity of going to the Bank for rediscount therefore did not exist. Moreover, the government was able through Ways and Means Advances to overdraw at the Bank of England to any amount necessary to meet its obligations. It thus enjoyed the alternative of Bank of England advances if the market was disinclined to accept its dictated rates on Treasury bills. By referring to the chart of the London money market during the war opposite page 279, it can be seen that the movement of rates after the market adjusted itself to war conditions in the summer of 1915 was very slight. From the summer of 1916 to the summer of 1919 the tendency under the influence of government control was downward. This was in accord with the policy of various Chancellors of the Exchequer to keep the cost of government borrowing at a minimum. The

movement upward which began in June, 1919 was a result of the beginning of Treasury decontrol and of the growing competition for funds from private enterprise. It is interesting to note, however, that because of the embargo on the export of gold and the inability of the Bank of England to exercise normal control of the market, the government itself raised the rate on commercial paper—or more precisely, on six months' Treasury bills — in advances of the rise in the Bank Rate.

The study of the chart will show little relationship between the flotation of government loans and market rates. This is another verification of what has been pointed out elsewhere; that the large volume of war borrowings was provided for by credit and currency inflation rather than by paying an increased price for the savings of the country as a whole. If a definite relationship between borrowing and saving had been maintained, the tendency of money rates from the middle of 1916 on would have been upward rather than downward. It is of course true that patriotism and the consciousness of the needs of the country were factors which would partly explain the willingness of the public to finance the government without *increased* rates, but this cannot be regarded as the principal explanation of the *fall* in rates. The explanation is complete government control and a policy of low rates secured through the medium of inflation.

V. THE MONEY MARKET AFTER THE WAR

(a) *Trade versus Treasury*

The floating debt, made up of Ways and Means Advances and Treasury bills and aggregating over 1200 million pounds, stood in the summer of 1919 as a competitor to trade for funds in the money market. This floating debt was to be converted from Ways and Means Advances into

Treasury bills as rapidly as possible, and Treasury bills, it was expected, would be greatly reduced by the flotation of new loans. Government expenditure in excess of revenue was tending to increase still further the volume of this floating debt, but the Chancellor of the Exchequer in a statement at the time held out hope that the peak of government borrowing would have been reached early in 1920. This expectation was realized, but a floating debt of 14 or 15 hundred million pounds had notwithstanding to be financed in the money market in competition with trade requirements, until conditions were propitious for the floating of loans large enough to reduce greatly the total amount. This was an obstacle to the development of British post-war commerce which gave bankers and merchants a great deal of concern. Aside from the fact that the volume of funds for trade financing was being thus limited, competition between the Treasury and trade might force up interest rates in a manner embarrassing to both. This was a factor retarding deflation and the resumption of the gold standard sometimes not recognized by writers on British post-war finance.

(b) *Money Market Decontrol*

The money market, as has been explained, was controlled throughout the war and during the immediate post-armistice period by the government. This control was effected through the artificial creation of the money-market fund supply by the Treasury, and by the use of these funds in turn largely by the Treasury itself. Rates were fixed on treasury bills and on surplus bank balances, and the agency which fixed the rates (the Treasury) made them effective through its power to increase the supply of "funds" should any evidence of stringency and competition from private sources threaten to shake the effectiveness of its control over the rates. To make this control still more far-reaching and to

extend it to investment funds, late in the war the banks were made parties to the scheme. In 1918, in order to stimulate the sales of National War Bonds, banking institutions of every kind receiving deposits entered into an agreement with the Chancellor of the Exchequer whereby they covenanted to make 3% the maximum rate for any moneys deposited with them.

During July, 1919, important steps were taken to remove the artificial means for controlling the money market. On the one hand, demand for government credit had slackened and public expenditure was being subjected to rigid supervision. Hence credit creation on the war-time scale was being considerably checked. On the other hand, trade demand for funds quickened and something approximating normal supply and demand conditions began to appear. On July 22, 1919, the banks were released from their covenant to pay no more than 3% on deposits by the Chancellor of the Exchequer. This release came on top of the decision also reached whereby the Bank of England no longer allowed interest on surplus balances of the banks, save when such balances represented moneys held on behalf of certain foreign countries. On these a preferential rate of 4½% was allowed. Late in October interest on foreign balances was also discontinued. Though Treasury bills were still offered at fixed rates for some time, the government, late in 1919, raised these rates as a further evidence of decontrol of the market. The Bank rate was at the same time likewise raised. Complete decontrol, however, was of course not reached until several years later.

(c) *Stock Exchange Decontrol*

On August 18, 1919, the Treasury removed practically all restrictions on the movement of capital. A Stock Exchange

correspondent of the *Economist* describes the effect of the Treasury's rulings as follows:[1]

The Treasury has taken a long stride in the direction of restoring to the Stock Exchange its *status quo ante bellum*. Remittances from the United Kingdom by way of loan, or for subscription to an issue of capital outside the United Kingdom, or for the purchase of securities, are now allowed; an American market may, therefore, be established in Shorter's Court once more. Import of bonds, stocks and shares to this country is permitted; foreigners, as well as our own countrymen abroad, can therefore sell in London. All undertakings not to sell are cancelled in regard to British Government securities compulsorily purchased with the proceeds of sales of stock that had not been held in physical possession in this country since September 30, 1914. Dealings are still prohibited,[2] except under license, in securities which have at any time since the outbreak of the war been in enemy ownership. These are the outstanding provisions of the Treasury's latest withdrawal of war restrictions that had been laid upon dealings in stocks and shares.

During the later post-war years all monetary controls were removed, but the money market did not again function normally until the restoration of the gold standard in 1925.

The foregoing are the methods and regulations by which the government controlled the London money market in the interest of war finance. In a general way the control was established through the mechanism of money and credit creation in the hands of the Bank as the agent of the Treasury. Because of the preponderance of "war business" over private trade the demand for funds was as completely in the hands of the government as the supply. As the war progressed, market funds were almost entirely taken up by Treasury bills. It was on these that daily quotations were

[1] Issue of August 23, 1919, p. 306.

[2] All remaining Stock Exchange restrictions were removed May 15, 1922.

made. Paper growing out of private commerce did not completely disappear, but became a minor factor in the market. Rates were not determined by competition but by government dictum, and thus were kept low when a free market would probably have made them high, as increases in rates with the coming of Treasury de-control seem to demonstrate. All the institutions which go to make up the London money market were therefore part of the general scheme of financial mobilization for war aims, as well as the Bank of England and the joint-stock banks. Financial control by the government during the war was most comprehensive and complete.

The final chapter will be devoted to a brief discussion of Great Britain's progress toward financial rehabilitation in the seven year period following the war.

CHAPTER VII

Financial Reconstruction

I. OUTSTANDING PROBLEMS OF FINANCIAL RECOVERY

The principal problems which Great Britain faced in getting her financial house in order after the war struggle were the trade balance, the balancing of the budget, and the re-establishment of the gold standard. These problems might be expressed in other terms, as ones of reducing Government expenditure, increasing taxation, funding the floating debt, the contraction of the fiduciary currency, the increase of production and of exports, and the reduction and stabilization of prices. The seriousness of the financial situation in the fall of 1919 is summed up in the fact that the Revised Statement of Revenue and Expenditure for 1919-1920, as given out by the Chancellor of the Exchequer on October 23, 1919, showed an estimated deficit of 473,645,000 pounds; that the Government was spending more than its revenue, though hostilities had ceased a year before; that the floating debt was in excess of 1,300 million pounds; and that the adverse commodity balance for the calendar year 1919 gave promise of being close to 700 million pounds, in contrast to 134 million pounds in 1913.

The beginning of 1920 marked a definite change for the better. Early in that year the peak of government expenditure was reached; income was increased, outgo curtailed, and the budget balanced. The slow, arduous struggle for financial recovery began. The fiscal year ending March 31, 1920, showed a deficit of 326 million pounds, instead of the esti-

mated deficit of 474 million pounds. This was largely due to the sale of war stocks amounting to 131 million pounds in excess of estimate. Taxes also considerably exceeded estimate. This, as well as the larger sale of war stocks, was made possible by stimulated business activity in the fall of 1919 and the spring of 1920. Taxes were still further increased for the fiscal year 1921, and war stock sales reached their peak in that year. From then on until 1926, when it showed a slight upward tendency, revenue steadily declined. More significant, however, was the even greater decline in expenditure which began before the close of the fiscal year 1920 and continued until 1926, when the items of civil service and national defence manifested a turn upward.[1]

In other words, the budgets for the five years from 1921 to 1925, inclusive, showed surpluses aggregating 430 million pounds. These sums were available for the reduction of the government's indebtedness, particularly the floating debt, which has been referred to as a serious obstacle to post-war financial recovery. This was reduced from 1,350 million pounds on December 31, 1919, to 704 million pounds at the close of the fiscal year 1926, a decrease of 646 million pounds. The total national debt for the same period was reduced 390 million pounds. The difference between the aggregate surpluses and the reduction of the total national debt is due to payments made in 1921 for the liquidation of certain external war commitments not included in the budget. The floating debt has been reduced partly by budget surpluses and partly by the sale of special treasury bonds issued in 1922. In 1921 the treasury changed its method of issuing treasury bills,[2] by making weekly tenders of definite allotments and letting the market fix the discount price. In the

[1] See table on p. 291.

[2] See p. 126.

spring of 1922 it instituted the practice of offering at the same time treasury bonds maturing in ten years or less, and exercising its option of issuing bills or bonds according to the price offered.

To provide for maturing National War Bonds, a 3½% forty-year Conversion Loan was offered in 1921. The terms were advantageous, and by March, 1922, 266 million pounds of these bonds were in the hands of the public. Favorable market conditions in 1922 stimulated further conversions of short-term government securities. These conversions tended to increase the principal of the national debt, but decreased the fixed debt charges. A 4½% Conversion Loan was offered in 1924, and in March, 1925, 210 million pounds were outstanding. A summary of the national debt from August 1, 1914, to March 31, 1926, showing changes from short-term to long-term conversion loans, is given on opposite page.[1]

The currency notes outstanding on December 31, 1919, amounted to 356,152,000 pounds. At the end of 1920 they had been increased to 367,626,000 pounds, due to the post-war inflation and the increase in prices. This was the peak year for currency issue, which declined from then on until 1922, when it was approximately 300 million pounds. It has dropped little since that date, standing on March 31, 1926, at 295,307,000 pounds. As has been pointed out elsewhere,[2] since 1919 the maximum fiduciary issue for any year has been fixed by the maximum of the year before. By another arrangement also made in 1919, however, Bank of England notes have been put into the Redemption Account of the Currency Notes Account,[3] which makes possible an

[1] London *Economist*, January 1, 1927, p. 33.

[2] See p. 34.

[3] In April, 1925, just prior to the reestablishment of the gold standard, the 28.5 million pounds gold coin in the Redemption Account was transferred to the Bank of England in exchange for bank notes.

Summary of British National Debt

(*Million £*)

	Aug. 1, 1914	Dec. 31, 1919	Mar. 31, 1922	Mar. 31, 1923	Mar. 31, 1924	Mar. 31, 1925	Dec. 31, 1925	Mar. 31, 1926	Dec. 31, 1926
Funded Debt	588	315	315	318	314	314	314	314	314
Term. Annuities	30	20	16	14	14	13	13	13	13
3½% Conversion Loan	..	..	266	684	666	709	764	764	760
4½% Conversion Loan	..	..	..	..	..	210	210	210	211
3½% War Stock	..	63	63	63	63	63	63	63	63
4½% War Stock	..	13	13	13	13	13	13	13	13
4% and 5% War Stock	..	2,047	1,953	2,095	2,166	2,052	2,052	2,052	2,109
National War Bonds	..	1,509	1,201	953	820	778	761	771	706
4% Funding Loan	..	409	401	399	396	395	395	395	390
4% Victory Bonds	..	360	335	325	314	350	350	350	292
Treasury Bonds	..	..	453	411	457	499	479	480	486
Exchequer Bonds	20	323	185	150	150	15	15	15	15
National Savings Certs.	..	267	342	354	366	369	372	375	373
Other Debt*	..	1,306	1,087	1,157	1,128	1,124	1,124	1,124	1,111
American Loan (Anglo-French)	..	51	..	..	..	..	..	..	..
Treasury Bills	15	1,107	878	616	588	576	635	565	663
Temporary Advances	1	243	147	194	186	167	181	139	182
	654	8,033	7,655	7,742	7,641	7,646	7,751	7,643	7,761
Other Capital Liabilities	57	46	66	70	66	72	84	85	77
Total Liabilities	711	8,079	7,721	7,812	7,707	7,718	7,835	7,728	7,778

* Includes debt to American Government.

expansion of the total issue of currency notes, although it definitely restricts the fiduciary part of the issue. Since the return of Great Britain to the gold standard on April 28, 1925, the currency notes have been tied up to the gold standard through the Bank of England notes, and there has in effect been since that time a parity of the currency notes with gold. The maintenance of a relatively fixed volume of currency notes since 1922 would indicate that the volume will remain fairly constant at that figure for some time to come. Prices have changed little in Great Britain since

1922. The *Economist's* index of wholesale prices for 1922 was 159.5, and at the end of July, 1926, was 150. The currency notes are serving the purpose of a circulating medium, and can be expanded under the stimulus of increased business activity and gold imports, through increases in the amount of Bank of England notes in the Redemption Account. On the other hand, excessive increase will be checked through its effect on the gold reserves of the Bank and the Bank rate. This matter will be given some further attention in discussing, later on in this chapter, the resumption of the gold standard.

An outstanding accomplishment in the process of post-war financial recovery was the settlement of the American debt question in the spring of 1923. This settlement was made on the basis of the amount of principal advanced, and interest at 4¼% up to December 15, 1922. After deducting a small amount paid on principal and interest in 1922, and after the payment by Great Britain of approximately $4,000,000 in cash, the sum which remained, and which was covered by the agreement, was $4,600,000,000. This is to be amortized over a period of 62 years, with interest at 3% for ten years and 3½% thereafter. The annual payments started at $161,000,000, and will be gradually increased to a maximum of $187,000,000.

The final achievement in the post-war financial recovery was the restoration of the gold standard in the spring of 1925. This will presently be discussed in detail.

This brief sketch outlines the steps which marked Great Britain's return to a financial normal. It is not meant to indicate that her financial problems are solved. Her war debt is still very large, and taxation must for many years be a heavy drain on the resources of the country. The progress outlined above is the progress back to the normal, healthy functioning of Great Britain's financial machinery. This

will be further clarified by a more detailed discussion of certain of its phases.

II. THE BUDGET SITUATION

(a) *Analysis of the Post-War Budget*

Some idea of the extent of Great Britain's burdens can be derived from an analysis of the budgets for the seven years from 1919 to 1926. These are given in a table on pp. 290 and 291. By referring back to the summary of national indebtedness on p. 287, it will be seen that the total government debt on August 1, 1914, was 654 million pounds, and on March 31, 1926, was 7,643 million pounds. This amounts to an almost twelve-fold increase. Debt charges decreased somewhat up to the fiscal year 1922-1923, and increased after that period. In 1925-1926 they were larger than in any post-war period. They must in the nature of the case show but little reduction for a number of years to come. The budget for 1913 was about 200 million pounds, so that the post-war debt charges alone are not far from twice the total prewar budget, and total expenditure, which has been fairly steady for the past four fiscal years at about 800 million pounds, is four times pre-war expenditures. On the other hand, the expenditures for the defence forces and the civil service show a very great decrease, for the last fiscal year, over that for 1920. Taxation has been decreased through the elimination of the excess profits duty and the reduction of the rates on income taxes. These latter still remain, however, at four shillings on the pound. Customs duties have decreased more than excise duties. The biggest decrease, however, has been in the miscellaneous receipts, which were for the most part proceeds from the sale of war stocks. The use of the proceeds from these sales has been criticized by writers in economic journals, who have contended that they should have been applied to the reduction

British Revenue and Expenditure, 1919–1926

Description	1919–1920 Actual Results	1920–1921 Actual Results	1921–1922 Actual Results	1922–1923 Actual Results	1923–1924 Actual Results	1924–1925 Actual Results	1925–1926 Actual Results
REVENUE	£	£	£	£	£	£	£
Estate Duties	40,904	47,729	52,191	56,871	57,800	59,450	61,200
Land Tax, House Duty and Mineral Rights Duty	3,303	2,570	2,590	2,980	2,760	1,450	950
Property and Income and Super Tax	359,099	394,146	398,887	379,045	329,971	336,516	327,921
Excess Profits Duty	290,045	219,181	30,452	2,004	....	700	2,000
Corporation Profits Tax	....	650	17,516	18,977	23,340	18,100	11,670
Customs	149,360	134,003	130,052	123,043	119,958	99,344	103,487
Excise	133,663	199,782	194,291	157,275	147,970	135,128	134,560
Motor Vehicle Duties	....	7,073	11,096	12,321	14,691	16,164	18,056
Stamp Duties	22,586	26,591	19,638	22,222	21,570	22,850	24,700
Total Taxation	998,960	1,031,725	856,713	774,738	718,060	689,702	684,544
Posts, Telegraphs and Telephones	44,150	49,500	56,400	53,200	52,800	55,450	57,350
Crown Lands	680	660	820	900	920	960	950
Interest on Sundry Loans	14,952	30,771	13,807	10,016	12,607	11,941	14,944
Miscellaneous Receipts *	280,829	313,329	197,140	75,158	52,782	41,383	54,272
TOTAL REVENUE	1,339,571	1,425,985	1,124,880	914,012	837,169	799,436	812,062

BRITISH REVENUE AND EXPENDITURE—*Continued*

Description	1919–1920	1920–1921	1921–1922	1922–1923	1923–1924	1924–1925	1925–1926
	Actual Results	Actual Results	Actual Results	Actual Results	Actual Results	Actual Results	Actual Results
EXPENDITURE	£	£	£	£	£	£	£
Debt Charges	332,034	349,599	332,294	323,990	347,309	357,161	358,229
Other Consolidated Fund Services	16,171	28,448	27,585	29,506	35,731	36,446	39,921
Defence Forces	604,028	292,228	189,440	111,000	105,800	114,700	119,377
Civil Services	569,054	460,216	449,700	286,826	239,366	226,134	243,263
Revenue Depts., Post Office, etc.	57,486	64,937	80,167	61,174	60,634	61,336	65,310
Votes of Credit—Naval and Military Operations	87,000	....	....	....	....	....	....
TOTAL EXPENDITURE	1,665,773	1,195,428	1,079,186	812,496	788,840	795,777	826,100
Surplus (+) or Deficit (—): £	—326,202	+230,557	+45,694	+101,516	+48,329	+3,659	14,038

Note.—The last three 000's are omitted throughout the whole table.
* Includes Fee and Patent Stamps and proceeds from the sale of War Stocks.

of the floating debt and not to current revenue. The drastic cut in expenditure for the defence forces in 1920-1921 over 1919-1920 indicates, however, that this source of government funds was not abused. It served as an effective means of financing the government during its peak expenditure in the year after the war. The uncompromising manner in which all expenditure was cut down is the best justification of the various Chancellors of the Exchequer in their post-war budget policies.

(b) *Special Taxation Measures*

The burden of debt charges has caused frequent discussion of ways and means of taking this great drain off the taxpayer through emergency taxation. The Chancellor of the Exchequer in his budget statement in the fall of 1919, however, said that there was no need of any special tax, that "additional taxation is not necessary unless the house desires a more rapid reduction of the national debt. Provision is made in our estimate for a half-percent sinking fund on the debt, a sum which if it is continued will be sufficient to redeem the debt in a little over 50 years."

It was estimated in the chapter on Government Borrowings that the *net* debt as a result of the war was 6,319 million pounds. This was arrived at after deducting loans made to the Dominions, one-half of the loans to the Allies, and the recoverable assets. Many financial writers have not been content to follow the Chancellor's suggestion of a reduction of the war debt over a period of fifty years, and various proposals have been made for the more rapid reduction of the debt. Some have urged a retroactive war-profits tax, and others a special capital tax to be paid in yearly installments against the outstanding debt. Though the Labor Party has been the chief sponsor of these measures, it lacked, during the short period of its government, a majority in

Parliament to translate them into legislation. Continued agitation for some form of capital tax may be expected for some years to come.

III. RESTORATION OF THE GOLD STANDARD

Prices and the volume of the currency, as has been pointed out, have been fairly stable since the fiscal year 1922-1923. The year 1924 saw the pound sterling reach a point within 3.5% of par. In February, 1925, it was within 1.3% of par, and continued to rise slowly until it reached gold parity on April 28, 1925. The restoration was brought about by an announcement of the Chancellor of the Exchequer on the latter date that the law of 1920 prohibiting gold exports except under special license would be permitted to lapse on December 31, and that for the rest of the year the Bank of England would have a general license to export gold. By the Gold Standard Act of May 13, 1925, the Bank of England was required to sell gold bars on demand at the usual mint price, but was not obligated to redeem its own notes or currency notes in gold coin. The purpose, which in general carried out the recommendations made in the First Interim Report of the Committee on Currency and Foreign Exchanges after the War,[1] was to prevent the use of gold for internal circulation, but to make it available for export by private individuals and banks after December 31, 1925, through the purchase of gold bars; the Bank in the meantime having full control of gold export movements. The Bank was further obligated to purchase all gold offered it at a fixed price as provided in the Act of 1884. To prevent speculation from adversely affecting sterling exchange rates, an issue of short-term securities was authorized and American credits amounting to $300,000,000 were opened, with the short-term securities as backing. Of these credits, one

[1] Cd. 9182, par. 23.

for $100,000,000 was opened by the British Treasury with its fiscal agents, J. P. Morgan & Company; the other, for $200,000,000, was procured by the Bank of England from the Federal Reserve Bank of New York. Under this arrangement, sterling was protected from speculative buying of dollar exchange, which would drain the gold resources of the Bank of England and weaken its reserve position. In order, however, that the Bank might not employ these credits other than as a protective reserve, it was stipulated that any use of them should be regarded as a corresponding loss from the Bank's own reserves, and its discount rate be determined accordingly. It is also generally understood that the Federal Reserve Bank has followed a discount policy in harmony with the efforts of the Bank of England to minimize the danger of gold transfers to New York.

Although certain British writers, notably John Maynard Keynes, had for some time opposed the restoration of the gold standard on the ground that it would bring about further deflation in a time of business depression, the restoration of this standard was not attended by any serious fall in wholesale prices. Prices showed a slight decline in June, and note circulation contracted somewhat. Although since the summer of 1925 British prices have fallen somewhat more rapidly than prices in Germany and the United States, it would not seem that this can be attributed to the resumption of the gold standard. Any effects on prices from such resumption would have occurred when the slack in currency volume was taken up. This slack seems to have been taken up and prices adjusted in June, 1925, as stated above. The explanation for subsequent declines in prices must be sought elsewhere. Contrary to the predictions of those who feared gold outflows, however, the movement was for the first few months toward London, so that in August the Bank rate was cut from 5% to 4½%, and in October to 4%. Because of

the heavy though normal cotton buying in the fall of 1925, gold began to flow out, and the Bank rate was raised to 5% on December 3rd. It remained at that point throughout the spring and summer of 1926. The restoration of the gold standard may be said to have been accomplished most successfully, and the problems of its maintenance now seem to be no greater than those which existed in the prewar days.[1]

Great Britain's real problems remain those of trade and industry. The war and the post-war disturbances throughout the world, together with the serious internal problems connected with such basic industries as the coal industry, are making difficult that thorough recovery of industrial production and trade upon which the country's well-being so vitally depends. A better understanding of Great Britain's trade situation and her balance of international payments can be secured by a study of the changes which the war has brought about in her yearly account with the outside world. It is upon the complete recovery of her prewar position that her success in giving employment to her people, meeting her external obligations, and becoming again an important exporter of capital must depend.

IV. THE BRITISH POST-WAR BALANCE OF PAYMENTS

In order that the trade balance be understood, we may start by analyzing Dr. C. K. Hobson's figures in his work on "The Export of Capital." It is a well-known fact that in addition to payment for exports of manufactured articles, the credits of the United Kingdom represent also, in part, payment for shipping services, banking and other services, and—the largest single item here—income from investments abroad. Further, there are minor increments in the shape of funds remitted home by Irish emigrants, tourist expen-

[1] For a complete analysis of the restoration of the gold standard, see the *Federal Reserve Bulletin*, June, 1925.

diture in the United Kingdom, Indian Government expenditure, etc. Whether these add to the visible excess of imports depends on the relative volume of payments in both directions. It is generally accepted, however, that Great Britain's invisible exports far exceed her invisible imports.

Over the decennial period 1903-1912, the excess of commodity imports over exports was, on an annual average, 160 million pounds. The total of shipping earnings, commissions for banking and other services in the same period is estimated at 135 million pounds per annum, on the average, and income from investments abroad (partly recorded in the Income Tax Returns and partly estimated) at 142 million pounds.

If the whole of these amounts represents "credits" over and above the amount due for goods exported — i. e., 277 million pounds—why is it that the visible excess of imports over exports is only 160 million pounds? In other words, what has become of the remaining 117 million pounds? This balance represents either or both of the following items: (a) new investments taken up; or (b) repayments of loans made by foreigners. There is no question that for the prewar period the first explanation is much the more reasonable of the two. The growth of "foreign investment" was in fact one of the commonplaces of financial discussion in those days, and was made the subject of bitter political comment as to the effect on the prosperity of the United Kingdom.

To ascertain with any degree of exactness the balance of payments of Great Britain for 1919 would require an elaborate investigation of every item entering into the trade balance. Two points are obviously most important: the degree to which the British incomes from investments abroad have fallen off, and the extent of earnings from shipping. If we take for the decrease in foreign investments the

"fashionable estimate" of 1,000 million pounds, of which we have already made mention, the net reduction in interest would be about 50 million pounds per annum. In addition to the loss of securities and the consequent loss of 50 million pounds per annum of interest, however, there were new debts contracted abroad to the extent of approximately 1,350 million pounds. Most of this was the debt to the United States. Over against this is to be set British loans to the Dominions and Allies, amounting to approximately 1,800 million pounds. On neither of these items was interest paid or received in 1919, and consequently this phase of the debt situation may be ignored in attempting to examine the reduction in interest receivable for that year. The British have taken the position that their war loans and borrowings would about offset each other, but the accurate determination of the interest account in the years following 1919 can be arrived at only by the careful checking of these items. The American debt has been funded, and the Allied debts partially funded. Great Britain has also been receiving some payments on account of reparations. The Board of Trade's estimate of interest for 1913 was 158 million pounds. Deducting from this the 50 million pounds referred to above will leave net interest for 1919 at 108 million pounds.

In regard to the shipping item, it must be borne in mind that although the loss of tonnage had been large, freights were high. An estimate of earnings from this source was made[1] by Sir Frederick Lewis of Furness, Withy & Co., Ltd., as between 350 and 400 million pounds for 1919. The third item is commissions and services, which the Board of Trade estimated for 1920 as 30 million pounds. This would seem a proper figure for 1919.

The trade excess of imports over exports for 1919 was

[1] London *Economist*, October 11, 1919, p. 570; London *Times*, October 11, 1919.

662,772,000 pounds. Adding the various credit items, namely: shipping, 350 million pounds; net interest, 108 million pounds; commissions and services, 30 million pounds, we get a total of 488 million pounds to be applied against the debit of 663 million pounds, leaving an apparent adverse balance of payments of 175 million pounds.

The difficulties of determining the exact adverse balance for 1919 are obvious, but this estimate seems to be as accurate as can be secured under the circumstances. Several other estimates, which varied to a considerable degree, were made in 1919. Barclay's Bank Circular for October, 1919, estimated a net adverse balance of 120 million pounds. The British Board of Trade has made estimates for several pre-war and post-war years, but has eliminated 1919 and 1921 from its tables. There is given herewith a statement by the Board of Trade giving balances of income and expenditure in transactions between the United Kingdom and all other countries for a series of years.

BALANCES OF INTERNATIONAL PAYMENTS OF THE UNITED KINGDOM

(*Million £*)

	1907	1910	1913	1920	1922	1923	1924	1925	1926
Excess of Imports of Merchandise and Bullion	142	159	158	343	171	220	349	395	477
Net National Shipping Income	85	90	94	340	110	133	140	124	120
Net Income from Overseas Investments	160	187	210	200	175	200	220	250	270
Commissions	25	25	25	40	30	30	60	60	60
Other Services	10	10	10	15	10	10	15	15	15
Total Invisible Exports on Balance	280	312	339	595	325	373	435	449	465
Income Available for Investment Overseas	138	153	181	252	154	153	86	54	−12
New Overseas Issues on London Market in Year	91	207	198	60	135	136	134	88	112

This table appeared in the *Board of Trade Journal* for January 29, 1925, but several corrections were made for the years 1923 and 1924, and the figures for 1925 added in a statement issued in the same journal of January 21, 1926. The figures for 1926 appeared in the issue of January 27, 1927, with 1924 and 1925 estimates revised. The table here given includes all the latest revisions. The statement shows a decrease in interest payments in 1922 over 1920, but an increase from that year on. Items for 1925 give interest on foreign investments at 250 million pounds, and for 1926 at 270 million pounds, which are in excess of the estimated amount for 1913. This increased estimate is explained by the continued accumulation of investments abroad since 1920, and large earnings during 1925 and 1926 of the rubber plantations in British Malaya and tea plantations in Ceylon. Returns from petroleum properties in various parts of the world are also a factor. Shipping shows a very large drop in 1922 over 1920, but in all post-war years is reckoned as higher than 1913. Higher rates largely explain this.

A most interesting phase of the matter is the new overseas issues on the London money market, which have aggregated over a half-billion pounds during post-war years. These increased in 1922, 1923, and 1924 over 1920, but fell off in 1925 and 1926. This latter year was affected by the coal strike, so that the estimated amount available for investment overseas was minus 12 million. Too close a relationship between the income available for investment overseas and the new overseas issues is not to be expected, because credits may be established in London to be drawn on in the future. Moreover, the table does not include transfers of bank balances from one country to another, whether they took the form of movements of funds to take advantage of a higher bank rate or, for example, of a transfer of money from the United States to London on account of payees in

the Netherlands or elsewhere, and kept in London pending the final orders of these payees. In 1924, at least, large amounts of subscriptions, notably those to the German loan, were still left in Great Britain at the end of the year, as bank deposits. It is apparent that Great Britain is exporting capital in something like prewar volume. It is notable that the 32½ million pounds now being paid annually to the United States on the war debt is only about one-fourth of the past five-year average of new overseas issues on the London market! A continuance of this export of capital however is primarily dependent on the state of the merchandise balance, which is a matter of the successful permanent solution of export trade problems. These are perhaps the outstanding problems facing Great Britain at the moment. The subject is too broad and far-reaching for discussion here. It involves the improvement of political and economic conditions in the world's buying markets for manufactured goods, increasing efficiency in British industry, and the replacement and modernizing of capital equipment.

V. LONDON'S FINANCIAL SUPREMACY

London's financial supremacy before the war was based on a number of factors which were due to Great Britain's geographical position in relation to Europe and to her political and industrial development during the 18th and 19th centuries. A study of the commerce of the British Isles is a study of enterprise, adventure and trading ability. Great Britain's insular position made her relatively free from the wars and political upheavals which retarded the economic development of the Continent. At the same time her position of relative security made it possible to carry on uninterrupted business with European countries even when they were at war with each other. In fact, her inability to increase her territory by annexation as population increased

made it necessary for her early to practice the policy of economic penetration into the then civilized countries of the world, and to seek, in the uncivilized, colonies which would make possible the industrial and commercial development of England by giving an immediate outlet for surplus production and a source of supply of raw materials—particularly food—essential to a territorially small country.

(a) *Financial Strength Based on Trading and Shipping:* Financial strength in the nineteenth century grew directly out of trading and shipping. English merchants did business in every part of the world, developing a merchant marine which carried not only their own commerce but also commerce between other countries. The extent of British trading, which penetrated the farthermost parts of the world, and which was greatly aided on the political side by the development of a Colonial Empire and a merchant marine far greater than that of any other country, led naturally to the use of London banking institutions as the agencies for financing this trade. As has been described in the chapter on the Money Market, the large merchant houses were the pioneers in financing trade, through the practice of guaranteeing the payments of their clients in various parts of the world. This, with the consequent development of an international discount market in London, was one of the most important factors in London's financial supremacy. London cannot remain a financial center of first importance if Great Britain does not continue to be a great trading country, with worldwide connections and to maintain a merchant marine of her own commensurate with the volume of her trade.

(b) *Low Price Levels:* A second factor of prime importance was the maintenance of price levels as low or lower than those of her principal trade rivals. Not only is this vital to her success in merchandising the goods which she produces, but it is also a condition of survival for her large

entrepôt business. Great Britain cannot remain a buyer of the world's products for resale and consequently remain a center for financing this trade if her costs for handling this business become higher than those of her competitors.

(c) *A Free Gold Market:* This is closely connected with the third cause of prewar supremacy, namely, the maintenance of free gold movements. The claims of other countries on London must be always realizable in gold if the prestige of London is to survive. This point involves again the discussion of the gold standard versus a "managed" currency. An excellent statement of the relation of a free gold market in London to the sterling bill appeared in the December, 1923, issue of the *Westminster Bank Review,* as quoted below:

The bill on London would no longer be exchangeable without question for a fixed weight of gold, but for a weight of gold varying with the quoted price. There would, therefore, be inevitably less demand abroad for the bill on London or for the sterling bank balance. No gold-exchange country would dare to hold sterling bills against its currency issue, when the amount of gold which they represent may vary by 4 or 5 (or more) per cent before they mature. No foreign banker would want to keep money on deposit in London merely on the assurance that it would always purchase the same quantity, not of gold or any other individual commodity, but of commodities in general. The sterling bill and the sterling bank balance would lose caste abroad. They would be less eagerly sought after, and our bankers, accepting houses, and discount houses would suffer in consequence. To the British trader, too, stability of internal prices can prove no satisfactory substitute for stable exchanges. Our foreign commerce, which is so large a proportion of our whole trade, requires stability abroad no less than stability at home. The scientifically perfect currency is of no use to the importer and the foreign merchant if their customers will not

accept it. . . . Any attempt to establish a system of currency which is not acceptable to the rest of the world, and which precludes full financial cooperation with other countries, would be a highly dangerous experiment. We must choose gold as long as the rest of the world clings to gold.

(d) *Freedom of Trade:* Equally important is the fourth condition of prewar supremacy; namely, the absence of restriction on the import and export of commodities. The post-war protectionist tendency in Great Britain is a direct menace to her position as a world trading and financial center. Many of her leaders see this and realize that it is impossible to remain the world center if the free exchange of commodities, particularly *through* the country as a world distributing center, is made difficult by tariff legislation.

(e) *Low Money Rates:* The maintenance of low price levels is wrapped up in the fifth cause of prewar supremacy; namely, low money rates for the financing of the world's trade. All things being equal, the merchants of other lands will use for credit accommodation the financial center where the rates are the lowest and the most steady. Fluctuations in rates tend to make difficult the estimate of costs of financing shipments, and London had in the days before 1914 a reputation for unvarying rates which inspired confidence throughout the world. No other money center could seriously compete with London in this regard. This, too, is related to the reestablishment of a free gold market in London and to London's preeminence as a trade financing center. The financing by London institutions in prewar days of so large a part of the world's trade meant the carrying of deposits there by banks in every section of the globe. The volume of these deposits meant a supply of funds always available for the buying of bills, and hence low and relatively unvarying rates of discount.

VI. EFFECT OF THE WAR ON LONDON'S PRESTIGE

The effect of the war on London, as has been pointed out throughout this study, was for the time at least to lessen her financial prestige. On the other hand, that of New York has been enhanced. The factors which have been enumerated as being the basis of London's prewar strength will continue to give her that strength in so far as they again fully obtain. The loss of investments abroad and the accumulation of a large external debt have enhanced the difficulties of trade and financial supremacy to the extent enjoyed before 1914; but offsetting this is the fact that Great Britain's principal trade rival—Germany—is prostrate and will be slow in recovering. Also the large rich territories acquired as a result of the war, together with the advancement of British military and naval prestige will be trade assets which, in the long run, may well offset war losses. America, on the other hand, has come to the front as an earnest competitor in world trade and shipping, with a demonstrated industrial strength never before realized, and credit resources which place her at the moment in a unique position. America's strength, however, though to an extent due to the stimulus of war production and to her ability under the war emergency to pay her debts to Europe and to become Europe's creditor, is partly relative—that is, she is strong in comparison to the weakness of Europe. When Europe has become economically normal and Great Britain has had an opportunity for thorough industrial and trade rehabilitation, America's advantages may to a very great extent be neutralized. In other words, a proper appraisal of the relative financial strength of London and New York must take into account fundamental factors and probable developments rather than be based entirely on an abnormal state of international relations.

VII. WILL NEW YORK SUPPLANT LONDON?

The answer to this question must be found in a consideration of London's ability to maintain those advantages which are the explanation of her prewar supremacy. Will America become a greater trading and shipping country than Great Britain? Will she develop and maintain trade in all parts of the world? Will her young men pioneer in new countries? Will large inter-nation business on the carrying and financial side be developed? Will a discount market be established in New York which will rival that of London in comprehensiveness and well-balanced working? Will the policy of political aloofness be given up and interest developed in the affairs of the world? — for trade is based on knowledge of political, social and religious conditions in the countries where goods are sold. Will credit be placed at the disposal of the world's trade needs at the sacrifice of larger profits in domestic development? Will the American public buy foreign securities and the New York Stock Exchange become a truly international rather than a national market? Will America reduce her price level by promoting free competition in her own markets, or will she endeavor to maintain, in the interests of her manufacturers, a level of prices higher than that of her trade rivals?

The answer to these questions is the answer to the question of New York succeeding London as the world's financial center. It is obvious that New York's position cannot be determined by purely financial considerations. If New York is to become supreme, that supremacy must be based on a whole group of contributing trade and economic factors.

America is undoubtedly making great progress and is possessed of a high type of industrial and commercial leadership. That she has advanced, especially along industrial lines, there can be no doubt, but that she has yet to learn

much from London is also certain. If one may venture to make a prediction, it is that London will continue to recover and become again the great banking, commercial and investment center that she was before the war. On the other hand, the prestige of New York as a financial center has been greatly enhanced and will undoubtedly continue to grow, thus sharing the responsibility with London in taking care of the world's financial requirements. For some time at least New York will be the more important center for investment funds; this will afford an opportunity for her to increase the volume of trade financed by her banks; but to assume that the financial center is automatically shifting from London to New York is to despise a competitor whose resources are still great and who has the financial "know how" to a remarkable degree.

Great Britain's most serious post-war problems, however, have been those of trade and industry rather than finance. Her people's knowledge of trade method and trading conditions the world over is second to that of no other nation, but conditions abroad since the war have been such as to make exporting difficult and frequently unprofitable. Many normal buying markets for British goods have been affected by reduced purchasing power and political upheaval. This has been particularly true on the continent and in Russia, India, and China. Furthermore, the war stimulated industrial development in many countries that previously produced mainly raw materials. This development is notable in the case of iron and steel, and especially so in the case of textiles. Great Britain, in contrast to the United States, does not have a large domestic market to compensate her. The industrial world-wide development which the war encouraged is being fostered by protective tariffs. Even China is demanding the right to be self-sustaining in textile production. World conditions and practically universal protectionist ten-

dencies have been giving no small concern to British manufacturers.

Moreover, Great Britain has been struggling with industrial problems of the most serious nature—diminished per-capita output, the coal crisis, and the general strike. These are but symptomatic of a more basic condition of economic ill health. Before the war England had been making little industrial progress, as this term is understood in Germany and the United States. Her schools, on the whole, gave little attention to the development of industrial technique, efficiency engineering, factory management, or personnel analysis. Drastic policies of plant and equipment scrapping have never been instituted. At the time the war broke out, British trade was feeling keenly the competition of an industrially alert Germany. The problems involved in industrial progressiveness are again pressing on the British manufacturer today. Germany is not yet a serious competitor, but the United States is in the field with a demonstrated industrial efficiency in advance of anything the world has yet known. Trading and financial technique will be of little avail to Great Britain if she does not seriously undertake the development of that industrial technique which is the basis of every other phase of her economic life.

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VITA

THE author was born on February 12, 1882. He received the degree of A.B. from St. Mary's University of Baltimore in 1907 and continued his studies by graduate work at the Catholic University, Washington, D. C., in 1907 and 1908. He went to the University of California in 1915-16 to study Economics, and to Columbia University in 1916-17. There he attended the seminars conducted by Professors Seligman, Mitchell, and Simkhovitch. His teaching experience includes lecturing on Money and Banking and the Industrial History of the United States at the College of the City of New York in 1916-17; lecturing on the Principles of Economics during the Summer Session at Columbia University 1917, and during the Winter and Spring Sessions in 1917 and 1918. He also taught Foreign Exchange at the Foreign Service School of Georgetown University, Washington, D. C., during the spring of 1921, and Foreign Trade at the University of California from August, 1921, to date. His government experience consisted of work as Special Expert for the Bureau of Planning and Statistics, United States Shipping Board, from 1918 to 1919; as Trade Commissioner on Financial Conditions in Europe, 1919-20; as Acting Commercial Attaché in England, Holland, and the continent in 1919-1920; and as Acting Chief Division of Research, Bureau of Foreign and Domestic Commerce in 1921. His business experience consists of serving as Director of the Foreign Trade Department of the San Francisco Chamber of Commerce. He has published government reports, collaborated on "Currencies after the War", book reviews, magazine and trade-paper articles, and has contributed to the Economic Section of the New York *Post*.